S. HRG. 101-870

THE FAIR TRADE IN FINANCIAL SERVICES ACT OF 1990

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

S. 2028

TO AMEND THE INTERNATIONAL BANKING ACT OF 1978 AND THE SECURITIES EXCHANGE ACT OF 1934 TO PROVIDE FOR FAIR TRADE IN FINANCIAL SERVICES

S. 2028 IS DESIGNED TO STRENGTHEN OUR TREASURY DEPARTMENT'S BARGAINING POWER TO OPEN FOREIGN MARKETS. UNDER IT, THE TREASURY HAS DISCRETION TO PERMIT BANKING AND SECURITIES REGULATORS TO DENY NEW APPLICATIONS FOR REGULATORY APPROVAL FROM FINANCIAL FIRMS FROM COUNTRIES THAT DISCRIMINATE AGAINST U.S. FIRMS

APRIL 5, 1990

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THE FAIR TRADE IN FINANCIAL SERVICES ACT OF 1990

THURSDAY, APRIL 5, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:05 a.m., in room SD–538 of the Dirksen Senate Office Building, Senator Donald Riegle (chairman of the committee) presiding.

Present: Senators Riegle, Cranston, Sarbanes, Dixon, Sanford, Shelby, Graham, Garn, Heinz, Gramm, and Bond.

OPENING REMARKS OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order.

Let me welcome all those in attendance this morning.

Before we move to our first witness, let me announce for the record, that as members arrive this morning, they will be recording their votes on favorably reporting the nominations of Robert C. Larsen and Phillip C. Jackson, Jr., to be members of the Oversight Board of the Resolution Trust Corporation, for terms of 3 years each.

So we will begin the period for voting now and it will extend until the hearing concludes. And if, during that time, a quorum is established, and I certainly hope that it will be, that the final vote will be announced as we adjourn, and the nominations will be reported to the full Senate today.

I think it's very important that we get these nominees confirmed and into service before the end of the week.

The CLERK. Senator Riegle?
The CHAIRMAN. Aye.
The CLERK. Mr. Cranston?
Senator CRANSTON. Aye.
The CLERK. Mr. Sarbanes?
Senator SARBANES. Aye.
The CLERK. Mr. Dodd?
Senator DODD. Aye, by proxy.
The CLERK. Mr. Dixon?
Senator DIXON. Aye.
The CLERK. Mr. Sasser?
[No response.]
The CLERK. Mr. Sanford?
Senator SANFORD. Aye.
The CLERK. Mr. Shelby?

Senator SHELBY. Aye.
The CLERK. Mr. Graham?
Senator GRAHAM. Aye.
The CLERK. Mr. Wirth?
Senator WIRTH. Aye, by proxy.
The CLERK. Mr. Kerry?
Senator KERRY. Aye, by proxy.
The CLERK. Mr. Bryan?
[No response.]
The CLERK. Mr. Garn?
Senator GARN. Aye.
The CLERK. Mr. Heinz?
Senator HEINZ. Aye.
The CLERK. Mr. D'Amato?
Senator D'AMATO. Aye, by proxy.
The CLERK. Mr. Gramm?
Senator GRAMM. Aye.
The CLERK. Mr. Bond?
Senator BOND. Aye.
The CLERK. Mr. Mack?
Senator MACK. Aye, by proxy.
The CLERK. Mr. Roth?
[No response.]
The CLERK. Mrs. Kassebaum?
[No response.]
The CLERK. Mr. Pressler?
Senator PRESSLER. Aye, by proxy.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. With respect to this morning's hearing, let me state that on January 29, Senator Garn and I, along with 9 other members of the committee, Senators Dixon, Shelby, Graham of Florida, Wirth, Kerry, Bryan, Heinz, D'Amato, and Pressler, together introduced S. 2028, the Fair Trade in Financial Services Act of 1990.

I think that bipartisan group reflects importantly the widely shared feeling on this committee that some additional steps of this kind are needed in this area.

So I want to just summarize some of our thinking as to why we're moving in this direction and why I hope we can get this bill enacted into law this year.

There is no doubt in my mind that we as Americans must pay greater attention to the fact that we are in a highly competitive global economy, when we consider our domestic policies, whether they be in the fiscal area, monetary area, social policy issues, education or what have you.

We must also, however, ensure that American firms get the same equality of competitive opportunity to compete abroad that we offer foreign firms in this country.

S. 2028 is designed to strengthen our Treasury Department's bargaining power to open foreign markets. Under it, the Treasury has discretion—and I underline that—it has discretion to permit our banking and securities regulators to deny new applications for reg-

ulatory approval from financial firms from countries that discriminate against U.S. firms.

I think opening foreign financial markets is important, not only to our firms trying to get into those markets, but also to our own institutions who are battling to hold onto markets here in our own country. For when foreign financial institutions enjoy a cartel-like protected market at home, they gain higher profits there and then can offer lower spreads and lower fees to foreign borrowers to subsidize their drive for market share abroad.

And so, in a sense, these two problems cross-connect that is, a protected home market provides the kind of monopoly gains that, in turn, can be used to subsidize a head-on competition here in a form that I think is quite unfair.

It's unfair on two counts, but certainly, we ought not to tolerate a situation where companies expect our firms to be handicapped in their home market settings and turn around and expect and enjoy national treatment here in the United States.

I welcome Treasury Under Secretary Mulford, who is with us this morning, and who I certainly respect in terms of the job that he does, and I know that view is widely shared here on the committee. In the past, he has expressed his frustration about negotiating with the Japanese to open their financial markets. I would cite in that reference a November 29th article in the Financial Times where Mr. Mulford is quoted as saying that:

> Statutory restrictions and regulatory practices continue to be a firm barrier to full access by foreign firms to the Japanese financial services industry. The situation invites congressional action. . . .

And I will stop at that point, but, obviously, his comments go on.

A number of us on the committee would like to take action, and that is why we have introduced S. 2028. I think we have an excellent group of distinguished witnesses present today to assist us in evaluating this bill, and we very much look forward to their testimony.

Senator Garn?

Senator GARN. Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR GARN

Today, the Banking Committee will examine the extent to which U.S. financial institutions competing internationally are treated fairly by other governments, a goal that I have been pursuing my entire Senate career.

I helped make national treatment the basis of U.S. policy in 1978, when the International Banking Act was passed.

I have spoken with other governments over the years seeking their adoption of this standard.

Out of frustration out of some of those trips to Australia and Korea and other countries, with the lack of progress in them attempting to adhere to the 1978 Act, in 1984, I proposed legislation to make denial of national treatment a consideration in approval of foreign banking applications by the Comptroller.

After 6 more years of painful progress and frustration, I have now joined the Chairman to cosponsor the Fair Trade in Financial Services Act. This is a very modest proposal, will strengthen the

hand of U.S. negotiators whose counterparts are backed by Japanese investment laws demanding full reciprocity and EC legislation that insists on reciprocal national treatment. It permits, but does not require, action against institutions from countries that discriminate against our institutions.

I cannot imagine the grounds for arguing that the Treasury should not have the authority to back up its negotiating persistence with credible authority.

I look forward to the witnesses we have today and look forward to the passage of this bill.

Again, I repeat, it's a very modest proposal and I would hope this time, the Treasury would agree with us. If not, we'll try and pass it, anyway. [Laughter.]

The CHAIRMAN. Thank you, Senator Garn.

Mr. Mulford, we're pleased to have you here this morning, and we'd like to hear from you at this time.

We'll make your full statement, of course, a part of the record, so feel free to summarize as much as you wish.

STATEMENT OF DAVID C. MULFORD, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. MULFORD. Thank you, Mr. Chairman. I will try to summarize quickly and finish within 7 or 8 minutes.

I am very pleased to be here today to discuss the Government's efforts to achieve national treatment for U.S. financial institutions and firms abroad.

In your invitation, you expressed concern that American firms may be losing their competitive edge in international finance and questioned the "equity of regulatory practices" in the United States and major foreign financial centers. The competitiveness issue of U.S. financial firms is of very great interest to this administration, and particularly to the Treasury.

You have aptly pointed out, Mr. Chairman, that this issue has many dimensions, of which world-wide regulatory equity is only one. Secretary Brady, as you may be aware, has asked the Treasury to examine related aspects of competitiveness in a comprehensive study on the cost of capital. I will focus my remarks today, as you requested, on the extent to which our national treatment policy has been successful, especially in Japan and in the European Community.

My written statement also comments on increased foreign penetration of U.S. financial markets, the diminished role of U.S. financial firms abroad, and the tendency of other major financial countries to adopt reciprocity or retaliatory powers.

First, I would like to emphasize that the principle of national treatment, as embodied in the International Banking Act of 1978, and in the OECD National Treatment Instrument and Codes of Liberalization, remains the cornerstone of Treasury's belief that everyone benefits from open financial markets which are accessed easily by domestic and foreign participants. We firmly believe that it is not sufficient simply to remove blatant discriminatory barriers. Foreign firms should effectively enjoy the same competitive

opportunities as domestic firms. Despite the moments of frustration and mounting pressure, we have not strayed from this principle.

Our efforts to implement national treatment have included national treatment studies and financial market talks. We continually monitor foreign financial markets and have intensified our scrutiny in the course of preparing the national treatment reports to the Congress in 1979, 1984, and 1986.

We are currently preparing the most extensive study thus far, which the 1988 Trade Act requires the Treasury Secretary to submit to the Congress later this year.

This study will be broader in scope and depth than previous studies. In fact, it will attempt to provide more complete answers to many of the questions you've raised.

In my remarks today, I do not wish to prejudge its conclusions because this study is only just getting underway.

The success of open U.S. financial markets prompted the Treasury to urge other countries to adopt national treatment. We have engaged in a series of financial market talks aimed at opening foreign markets and creating a level playing field for U.S. firms.

Perhaps the most notable progress has been in the Treasury's financial discussions with Japan. The so-called Yen/Dollar group, now known as the United States-Japan Working Group on Financial Markets, has met 13 times since early 1984. These talks, which I lead on the United States side, have contributed to substantially greater access for United States firms to Japanese financial markets—to their stock exchanges, Government securities markets, the Euroyen market and, to a lesser degree, Japanese domestic money markets.

This is not to say our work is complete. We are continuing to press for more rapid interest rate deregulation and the development of a short-term money market, as well as further progress across a range of issues. These include examining Japanese laws which frustrate foreign financial firms in offering innovative products and services to Japanese investors.

Progress has been steady, but slow. At times, very slow.

The Japanese have recently indicated their intention to expand use of the auction process in the Government securities market, increase the number of seats on the Tokyo Stock Exchange, and accept applications for investment trust management licenses. We intend to continue these discussions in Tokyo next month.

We have also worked with our colleagues in the European Community as they have drafted legislation to establish an integrated market in banking and securities by the end of 1992. We expressed particular concern about a potential mirror-image reciprocity provision which was initially included in the Second Banking Directive and a similar provision in the directive on investment services. The EC subsequently revised the Second Banking Directive to provide for reciprocal national treatment and effective market access, although it still provides for sanctions when third countries do not provide national treatment.

We will continue to monitor developments in this area to avoid potential discrimination against firms from non-EC countries.

Overall, Mr. Chairman, our efforts have been successful, if in varying degrees. Our talks with the Canadians produced a land-

mark financial services agreement, as part of the 1989 United States-Canada Free Trade Agreement, which removed many discriminatory practices. We are moving forward slowly but steadily with Taiwan and Korea.

During our financial policy talks in February, the Koreans agreed to several measures which should enhance foreign banks' access to local currency funding in the Korean money market. The Koreans also agreed to abide by the scheduled opening of the securities sector to foreign firms. We are now waiting for evidence to support Korea's intentions.

In Latin America, we have made the least progress. Some of these countries, such as Venezuela and Mexico, have adopted a new openness in trade which I hope will spread into their financial sectors.

It is difficult to justify, Mr. Chairman, that major debtor countries receiving support from a variety of sources under the strengthened debt strategy should maintain financial systems that remain substantially closed to the financial community.

We intend to follow up discussions with these and other markets as we pursue our efforts.

Finally, Mr. Chairman, let me comment on the financial services in the Uruguay Round. This facet of the Uruguay Round is a relatively new effort to improve opportunities for U.S. financial institutions in foreign markets.

At Treasury's initiative, finance officials have begun to craft an agreement which would contain legally-binding obligations calling for both market access and national treatment for financial institutions.

The OECD countries have already made considerable progress in this area. The Uruguay Round provides an opportunity to pursue liberalization in a wider range of countries, including the newly industrialized economies of Asia and Latin America.

To return to our original discussion, Mr. Chairman, I believe the United States has been well served by our policy of national treatment. At home, the U.S. domestic market has benefited and abroad, we have made some significant strides in opening markets, although usually as a result of arduous negotiations. National treatment has its limitations, and I'm clearly aware of those. But they may be less dangerous than those associated with other alternatives.

Since at the Federal level we offer national treatment in the U.S. market, we do not have a test to determine whether a foreign financial firm should be allowed to enter or increase the scope of its activities in the United States based on the openness of its home country.

In this regard, we are increasingly in a minority in the international community. For example, with the adoption of reciprocal national treatment that will become operative on January 1, 1993, under the EC's Second Banking Directive, at least 18 out of 24 OECD members will have reciprocity powers.

The CHAIRMAN. Can I just stop you there for a minute? I think that's such an important statistic that you've brought us.

Doesn't that tell us that that's where the world is going?

Mr. MULFORD. I think it does tell us that the world has been moving in that direction, Mr. Chairman. I think that's correct.

The CHAIRMAN. Well, I'll comment further on it when you finish.

Mr. MULFORD. On the other hand, though, Mr. Chairman, we have also seen substantial progress towards national treatment in OECD countries.

You inquired specifically about Japan and the European Community.

Broadly speaking, we understand that Japan does not, in practice, require reciprocity beyond a general assurance that its firms have a right of establishment in foreign countries. And perhaps we can come back to that in questioning.

The EC officials, on the other hand, maintain that on January 1, 1993, the EC will move to a unified banking market which places less restraint on what financial institutions can do than exists in the United States or Japan. Given the EC's repeated desire to maintain open markets, it seems unlikely that the EC's reciprocity powers under the Second Banking Directive would be used in the present environment against U.S. financial institutions.

Nevertheless, in a listing of significant world-wide practices where the EC sees room for improvement, EC officials question the appropriateness of the 1933 Glass-Steagall restrictions on universal banking in the global financial markets of the 1990's.

They also note that the McFadden Act restricts geographical expansion and that certain States deny national treatment and discriminate against banks from other States whose parent banks are not U.S. owned. They cite Federal Reserve limits on daylight overdrafts which they claim place foreign banks at a competitive disadvantage in U.S. markets.

EC officials maintain that those who oppose reciprocity and urge national treatment abroad should be careful to ensure that their own domestic practices are beyond criticism.

Mr. Chairman, I notice that the red light has gone on.

The CHAIRMAN. Well, don't worry about that. Take your time. What you have to say is of great interest to us.

Mr. MULFORD. Fine. I just have a couple more minutes.

I must admit that in the United States, we often fail to realize how our own highly regulated and fragmented markets are viewed from overseas. Even though at the Federal level we pursue a policy of national treatment, at the State level there are denials of national treatment. When foreign firms or foreign governments bring specific complaints to the Treasury's attention, we act on them, writing to the States in question requesting that national treatment be given, but of course, we cannot force it.

To conclude, Mr. Chairman, I would like to emphasize my support for this committee's concern about the absolute need for open markets and equal access to competitive opportunities in our rapidly integrating financial world.

As I have stated, the Treasury has been actively pursuing national treatment for U.S. financial firms in foreign markets through discussions with other countries. In different fora, we have engaged in financial market talks with Japan, the European Community, Korea, Taiwan and Canada.

We have also raised our concerns with Latin American officials. We have worked with the OECD to strengthen the codes of liberalization with respect to the financial services sector and to upgrade the National Treatment Instrument. In addition, we are rapidly moving forward in our preparations for the 1990 National Treatment Study—a comprehensive study which will thoroughly analyze the treatment of U.S. financial institutions abroad.

In this context, we have studied with interest the Fair Trade in Financial Services Act of 1990. We certainly appreciate its objectives of promoting progress in opening foreign markets for U.S. financial firms. However, the administration must oppose this bill for the same reasons that it has opposed and expressed concern about reciprocity in the European Community's financial services directives.

The U.S. objection to even limited reciprocity is the risk that reciprocity would be used and retaliation would follow. The impact could be devastating to confidence in world financial markets and established pattern of monetary and capital flows.

The President has clearly stated his opposition to measures for increased protectionism that might restrict the flow of capital. The market place should be free to allocate resources.

Thus, in seeking progress, the administration prefers to encourage other countries to open and liberalize their markets to our mutual advantage, rather than to threaten to deny foreign firms access to our own market.

Thank you very much, Mr. Chairman.

[The complete statement of David C. Mulford follows:]

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Expected at 10:00 a.m.
Thursday, April 5, 1990

TESTIMONY OF DAVID C. MULFORD
UNDER SECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS
BEFORE
THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
OF THE
UNITED STATES SENATE
APRIL 5, 1990

INTRODUCTION

I am pleased to be here today to discuss the Government's efforts to achieve national treatment for U.S. financial firms abroad. In your invitation, you expressed concern that American firms may be losing their competitive edge in international finance, and questioned the "equity of regulatory practices" in the United States and major foreign financial centers. The competitiveness issue of U.S. financial firms is of great interest to this Administration and particularly to the Treasury Department.

You have aptly pointed out that this issue has many dimensions of which worldwide regulatory equity is only one. Secretary Brady, as you may be aware, has asked the Treasury to examine related aspects of competitiveness in a comprehensive study on the cost of capital. I will focus my remarks today, as you requested, on the extent to which our national treatment policy has been successful, especially in Japan and the European Community. I will also comment on increased foreign penetration of U.S. financial markets, the diminished role of U.S. financial firms abroad, and the tendency of other major financial countries to adopt reciprocity or retaliatory powers.

NATIONAL TREATMENT POLICY

First, I would like to emphasize that the principle of national treatment, as embodied in the International Banking Act of 1978 and the OECD National Treatment Instrument and Codes of Liberalization, remains the cornerstone of Treasury's belief that everyone benefits from open financial markets which are

accessed easily by domestic and foreign participants. We firmly believe that it is not sufficient simply to remove blatant discriminatory barriers. Foreign firms should effectively enjoy the same competitive opportunities as domestic firms. Despite moments of frustration and mounting pressure we have not strayed from this principle.

National Treatment Studies

Our efforts to implement national treatment have included national treatment studies and financial market talks. We continually monitor foreign financial markets and have intensified our scrutiny in the course of preparing the national treatment reports to the Congress in 1979, 1984 and 1986. We are currently preparing the most extensive study thus far, which the 1988 Trade Act requires the Treasury Secretary to submit to the Congress later this year.

This study will be broader in scope and depth than previous studies. It will report on the treatment accorded U.S. banks and securities firms in foreign markets and describe our efforts to reduce discriminatory treatment. We will prepare detailed country chapters and also report on the activities of foreign financial institutions in the U.S. In fact, this study will attempt to provide more complete answers to many of the questions you have raised. In my remarks today, I do not want to prejudge its conclusions.

Financial Market Talks

The success of open U.S. financial markets prompted the Treasury to urge other countries to adopt national treatment. We have engaged in a series of financial market talks aimed at opening foreign markets and creating a level playing field for U.S. firms. For example, we have met with our counterparts from Japan, Canada, the European Community, Taiwan and Korea to discuss a wide range of financial market issues. We have also raised financial market issues with Latin American officials. Since you have expressed particular interest in Japan and the EC, let me turn briefly to our efforts in these markets.

Japan

Perhaps the most notable progress has been in Treasury's financial discussions with the Japanese. The so-called Yen/Dollar group, now known as the U.S.-Japan Working Group on Financial Markets, has met thirteen times since early 1984. These talks, which I lead on the U.S. side, have contributed to substantially greater access for U.S. firms to Japanese financial markets -- to their stock exchanges, government securities markets, the Euroyen market and, to a lesser degree, Japanese domestic money markets.

This is not to say our work is complete. We are continuing to press for more rapid interest rate deregulation and the development of a short-term money market as well as further progress across a range of issues. These include examining Japanese laws which frustrate foreign financial firms in offering innovative products and services to Japanese investors. Progress has been steady, but slow. The Japanese have recently indicated their intention to expand use of the auction process in the government securities market, increase the number of seats on the Tokyo Stock Exchange and accept applications for investment trust management licenses. We intend to continue these discussions in Tokyo next month.

European Community

We have also worked with our colleagues in the European Community as they have drafted legislation to establish an integrated market in banking and securities by the end of 1992. We expressed particular concern about a potential mirror-image reciprocity provision which was initially included in the Second Banking Directive and a similar provision in the directive on investment services. These directives are part of the major liberalization and regulatory framework for the 1992 market. The EC subsequently revised the Second Banking Directive to provide for reciprocal national treatment and effective market access, although it still provides for sanctions when third countries do not provide national treatment. We will continue to monitor developments in this area to avoid potential discrimination against firms from non-EC countries.

General Outcome

Overall, our efforts have been successful, if in varying degrees. Our talks with the Canadians produced a landmark financial services agreement, as part of the 1989 U.S.-Canada Free Trade Agreement, which removed many discriminatory practices. We are moving forward slowly but steadily with Taiwan and Korea. During our financial policy talks in February, the Koreans agreed to several measures which should enhance foreign banks' access to local currency funding in the Korean money market. The Koreans also agreed to abide by the scheduled opening of the securities sector to foreign firms. We now are waiting for evidence to support Korea's intentions.

In Latin America we have made the least progress. Nevertheless, we will continue to urge financial market reforms and more liberal investment policies in Latin American countries, especially in conjunction with development bank lending. Some of these countries, such as Venezuela and Mexico, have adopted a new openness in trade which I hope will spread to their financial sectors. It is difficult to justify that major debtor countries

receiving support from a variety of sources under the strengthened debt strategy should maintain financial systems that remain substantially closed to the world financial community. We intend to have follow-up discussions with these and other markets as we pursue our efforts. The 1990 National Treatment Study, currently underway, will help identify problem areas.

The Uruguay Round

Finally, let me comment on financial services in the Uruguay Round. This facet of the Uruguay Round is a relatively new effort to improve opportunities for U.S. financial institutions in foreign markets. At Treasury's initiative, finance officials have begun to craft an agreement which would contain legally binding obligations calling for both market access and national treatment for financial institutions. The OECD countries have already made considerable progress in this area. The Uruguay Round provides an opportunity to pursue liberalization in a wider range of countries, including the newly industrializing economies of Asia and Latin America.

COMPETITIVENESS OF U.S. BANKS

You expressed concern that the position of U.S. banks has steadily declined while other foreign banks, particularly Japanese banks, have rapidly gained strength and market share.

I agree that U.S. banks have lost their position of world dominance. Not only has their position declined worldwide, it has also declined in the United States. Meanwhile, Japanese banks have increased their market share around the world and their penetration in the United States. This has occured while U.S. banks have acquired only a negligible share of the Japanese market and have not enjoyed the same ease of access the Japanese banks have enjoyed in the United States.

There are a number of factors which account for U.S. banks drawing back from foreign markets. Some result from international developments, including exchange rate changes, while others stem from U.S. domestic considerations. One difficulty facing U.S. banks has been the political and legislative uncertainties surrounding the future landscape of the U.S. financial system. The ability of U.S. banks to compete on all fronts with foreign banks abroad has, in part, been hampered by U.S. restrictions on their activities. Limitations in the United States have also curtailed U.S. banks' activities domestically including inter-state banking. Nevertheless, without going into statistical detail (1988 is the last full year for which complete internationally comparative data are available), I agree, that for a variety of reasons, U.S. banks have lost a major competitive position.

NATIONAL TREATMENT VERSUS RECIPROCITY

To return to our original discussion, I believe the United States has been well served by our policy of national treatment. At home, the U.S. domestic market has benefited and abroad we have made some significant strides in opening markets, although usually as a result of arduous negotiations. National treatment has its limitations, but they may be less dangerous than those associated with other alternatives.

Since at the Federal level we offer national treatment in U.S. markets, we do not have a test to determine whether a foreign financial firm should be allowed to enter or increase the scope of its activities in the United States based on the openness of its home country. In this regard, we are increasingly in a minority in the international community.

OECD Countries

For example, in 1984, the OECD found that 11 of the 24 OECD members had some form of reciprocity powers available. Since then, other countries have added reciprocity powers. With the adoption of reciprocal national treatment that will become operative on January 1, 1993 under the EC's Second Banking Directive, at least 18 out of 24 OECD members will have reciprocity powers. We have pressed our concerns about the consistency of these new reciprocity measures with OECD members.

On the other hand, we have also seen substantial progress towards national treatment in OECD countries since 1984. This is true in the Scandinavian countries, in Australia, Canada, Japan, Switzerland, many other European countries, and even under the EC Second Banking Directive, provided that it operates in a non-discriminatory manner.

You inquired specifically about Japan and the European Community.

Japan

Broadly speaking, we understand that Japan does not, in practice, require reciprocity beyond a general assurance that its firms have a right of establishment in foreign countries. However, Japan's banking law does contain language which requires the Minister of Finance, in reviewing a foreign institution's banking license application, to examine whether Japanese banks are entitled to equivalent status in the foreign country. In effect, this is a provision for reciprocity. However, Japan's Ministry of Finance appears to apply this standard flexibly, focusing only on markets which specifically prohibit the presence of Japanese banks. On the securities side, there are no statutory or regulatory reciprocity provisions.

The European Community

EC officials maintain that on January 1, 1993, the EC will move to a unified banking market which places less restraint on what financial institutions can do than exists in the United States or Japan. Given the EC's repeated desire to maintain open markets, it seems unlikely that the EC's reciprocity powers under the Second Banking Directive would be used in the present environment against U.S. financial institutions. We will continue to monitor the implementation of this and other directives.

Nevertheless, in a listing of significant worldwide practices where the EC sees room for improvement, EC officials question the appropriateness of 1933 Glass-Steagall restrictions on universal banking in the global financial markets of the 1990s. They also note that the McFadden Act restricts geographical expansion and that certain states deny national treatment and discriminate against banks from other states whose parent banks are not U.S.-owned. They cite Federal Reserve limits on daylight overdrafts which they claim place foreign banks at a competitive disadvantage in U.S. markets. EC officials maintain that those who oppose reciprocity and urge national treatment abroad should be careful to ensure that their own domestic practices are beyond criticism.

United States

I must admit that in the United States we often fail to realize how our own highly regulated and fragmented markets are viewed overseas. Even though at the federal level we pursue a policy of national treatment, at the state level there are denials of national treatment. When foreign firms or foreign Governments bring specific complaints to the Treasury's attention, we act on them, writing to the states in question, requesting that national treatment be given, but we cannot force it.

Moreover, we should not forget that in addition to Federal requirements, the 50 states each have securities and banking laws that must be observed. This is not a denial of national treatment, but while normal to us, it might appear daunting to a foreigner.

CONCLUSION

To conclude, I would like to emphasize my support for this Committee's concern about the absolute need for open markets and equal access to competitive opportunities in our rapidly integrating financial world. As I have stated, the Treasury has been actively pursuing national treatment for U.S. financial

firms in foreign markets through discussions with other countries. In different fora, we have engaged in financial market talks with Japan, the European Community, Korea, Taiwan, and Canada. We have also raised our concerns with Latin American officials. We have worked with the OECD to strengthen the Codes of Liberalization with respect to the financial services sector and to upgrade the National Treatment Instrument. In addition, we are rapidly moving forward in our preparations for the 1990 National Treatment Study -- a comprehensive study which will thoroughly analyze the treatment of U.S. financial institutions abroad.

In this context, we have studied with interest the "Fair Trade in Financial Services Act of 1990" (S.2028). We certainly appreciate its objective of promoting progress in opening foreign markets for U.S. financial firms. However, the Administration must oppose this bill for the same reasons that it has opposed and expressed concern about reciprocity in the European Communities' financial services directives.

The U.S. objection to even limited reciprocity is the risk that reciprocity would be used and retaliation would follow. The impact could be devastating to confidence in world financial markets and established patterns of monetary and capital flows. The President has clearly stated his opposition to measures that might restrict the flow of capital or increase protectionism -- the market place should be free to allocate resources. The Department of Justice has constitutional concerns about certain provisions of this bill which it will address in a separate letter. Thus, in seeking progress, the Administration prefers to encourage other countries to open and liberalize their markets, to our mutual advantage, rather than threaten to deny foreign firms access to our own.

101ST CONGRESS
2D SESSION

S. 2028

To amend the International Banking Act of 1978 and the Securities Exchange Act of 1934 to provide for fair trade in financial services.

IN THE SENATE OF THE UNITED STATES

JANUARY 29 (legislative day, JANUARY 23), 1990

Mr. RIEGLE (for himself, Mr. GARN, Mr. DIXON, Mr. SHELBY, Mr. GRAHAM, Mr. KERRY, Mr. BRYAN, Mr. HEINZ, Mr. D'AMATO, Mr. PRESSLER, and Mr. WIRTH) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To amend the International Banking Act of 1978 and the Securities Exchange Act of 1934 to provide for fair trade in financial services.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Fair Trade in Financial Services Act of 1990".

SEC. 2. EFFECTUATING THE PRINCIPLE OF NATIONAL TREATMENT FOR BANKS.

The International Banking Act of 1978 (12 U.S.C. 3101 et seq.) is amended by adding at the end the following:

"NATIONAL TREATMENT

"SEC. 15. (a) GENERAL RULE.—A Federal banking agency may deny any application, or disapprove any notice, filed by a person of a foreign country if the Secretary of the Treasury has published in the Federal Register (and has not revoked) a written determination that the foreign country does not offer United States banks and bank holding companies the same competitive opportunities (including effective market access) as are available to its domestic banks and bank holding companies.

"(b) PERSON OF A FOREIGN COUNTRY DEFINED.—A person of a foreign country is a person that—

"(1) is organized under the laws of that country;

"(2) has its principal place of business in that country;

"(3) in the case of an individual—

"(A) is a citizen of that country, or

"(B) is domiciled in that country; or

"(4) is directly or indirectly controlled by a person described in paragraph (1), (2), or (3).

"(c) NEGOTIATIONS REQUIRED.—

"(1) The Secretary of the Treasury shall initiate negotiations with any foreign country described in subparagraphs (A) and (B) of subsection (d)(1) to ensure that that country offers United States banks and bank

holding companies the same competitive opportunities (including effective market access) as are available to its domestic banks and bank holding companies.

"(2) Paragraph (1) does not require the Secretary of the Treasury to initiate negotiations with a foreign country if the Secretary—

"(A) determines that such negotiations would be fruitless or would impair national economic interests; and

"(B) gives written notice of that determination to the chairman and ranking minority member of the Committee on Banking, Housing, and Urban Affairs of the Senate and of the Committee on Banking, Finance and Urban Affairs of the House of Representatives.

"(d) ANNUAL REPORTS REQUIRED.—For each calendar year beginning on or after January 1, 1991, the Secretary of the Treasury shall, not later than May 1 of the following calendar year, submit to the Congress a report—

"(1) identifying each foreign country—

"(A) that, according to the most recent report submitted under section 3602 of the Omnibus Trade and Competitiveness Act of 1988, does not offer United States banks and bank holding companies the same competitive opportunities (in-

cluding effective market access) as are available to its domestic banks and bank holding companies; and

"(B) with respect to which no written determination under subsection (a) is in effect;

"(2) explaining why the Secretary has not made, or has revoked, such a determination with respect to that country; and

"(3) describing the results of negotiations conducted pursuant to subsection (c)(1).".

SEC. 3. EFFECTUATING THE PRINCIPLE OF NATIONAL TREATMENT FOR SECURITIES BROKERS AND DEALERS.

Section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)) is amended by adding at the end the following new paragraph:

"(11)(A) This paragraph shall apply with respect to a foreign country if the Secretary of the Treasury has published in the Federal Register (and has not revoked) a written determination that the foreign country does not offer United States brokers and dealers the same competitive opportunities (including effective market access) as are available to its domestic brokers and dealers.

"(B)(i) The Commission may—

"(I) deny any application for registration under this subsection filed by a person of a foreign country to which this paragraph applies; and

"(II) prohibit any person of that foreign country from acquiring control of a registered broker or dealer, irrespective of when the acquisition was initiated.

"(ii) No person of that foreign country, acting directly or indirectly, shall acquire control of any registered broker or dealer unless—

"(I) the Commission has been given notice 45 days in advance of the acquisition, in such form as the Commission shall prescribe by rule; and

"(II) the Commission has not prohibited the acquisition.

"(iii) The Commission may, by order, extend the notice period with respect to any particular acquisition for not more than 60 days.

"(C) A person of a foreign country is a person that—

"(i) is organized under the laws of that country;

"(ii) has its principal place of business in that country;

"(iii) in the case of an individual—

"(I) is a citizen of that country, or

"(II) is domiciled in that country; or

"(iv) is directly or indirectly controlled by a person described in clause (i), (ii), or (iii).

"(D)(i) The Secretary of the Treasury shall initiate negotiations with any foreign country described in subclauses (I) and (II) of subparagraph (E)(i) to ensure that that country offers United States brokers and dealers the same competitive opportunities (including effective market access) as are available to its domestic brokers and dealers.

"(ii) Clause (i) does not require the Secretary of the Treasury to initiate negotiations with a foreign country if the Secretary—

"(I) determines that such negotiations would be fruitless or would impair national economic interests; and

"(II) gives written notice of that determination to the chairman and ranking minority member of the Committee on Banking, Housing, and Urban Affairs of the Senate and of the Committee on Energy and Commerce of the House of Representatives.

"(E) For each calendar year beginning on or after January 1, 1991, the Secretary of the Treasury shall, not later than May 1 of the following calendar year, submit to the Congress a report—

"(i) identifying each foreign country—

"(I) that, according to the most recent report submitted under section 3602 of the Omnibus Trade and Competitiveness Act of 1988, does not offer United States brokers and dealers the same competitive opportunities (including effective market access) as are available to its domestic brokers and dealers; and

"(II) with respect to which no written determination under subparagraph (A) is in effect;

"(ii) explaining why the Secretary has not made, or has revoked, such a determination with respect to that country; and

"(iii) describing the results of negotiations conducted pursuant to subparagraph (D)(i).".

SEC. 4. CONFORMING AMENDMENTS SPECIFYING THAT NATIONAL TREATMENT INCLUDES EFFECTIVE MARKET ACCESS.

(a) QUADRENNIAL REPORTS ON FOREIGN TREATMENT OF UNITED STATES FINANCIAL INSTITUTIONS.—Section 3602 of the Omnibus Trade and Competitiveness Act of 1988 (22 U.S.C. 5352) is amended by adding at the end the following: "For purposes of this section, a foreign country denies national treatment to United States entities if it does not offer them the same competitive opportunities (including ef-

fective market access) as are available to its domestic entities.".

(b) NEGOTIATIONS TO PROMOTE FAIR TRADE IN FINANCIAL SERVICES.—Section 3603(a)(1) of the Omnibus Trade and Competitiveness Act of 1988 (22 U.S.C. 5353(a)(1)) is amended by inserting "effective" after "banking organizations and securities companies have".

(c) PRIMARY DEALERS IN GOVERNMENT DEBT INSTRUMENTS.—Section 3502(b)(1) of the Omnibus Trade and Competitiveness Act of 1988 (22 U.S.C. 5342) is amended—

(1) by striking "does not accord to" and inserting "does not offer";

(2) by inserting "(including effective market access)" after "the same competitive opportunities in the underwriting and distribution of government debt instruments issued by such country"; and

(3) by striking "as such country accords to" and inserting "as are available to".

○

The CHAIRMAN. Thank you, Mr. Mulford.

I must say that I'm disappointed that the administration is not more forthcoming on this issue. I very much agree with Senator Garn that we need to move ahead.

I don't see much progress coming, frankly, of the sort that we need to see. Do you feel that in Japan today, for example, that American financial institutions are given the same opportunities to establish themselves and compete fairly and equitably as are Japanese financial firms?

Mr. MULFORD. In Japan?

The CHAIRMAN. Yes.

Mr. MULFORD. I think the answer to that is that it's a highly complex answer. I think there are cases, yes, where we have accomplished that objective. But as I've said a number of times, and including in the article that you referred to, we have only accomplished about half of the mission in Japan. We are now on the second half, which is even tougher than the first half.

There is, as I've said, a combination in Japan of laws, regulations, conventions, practices, obscure absence of transparency, and so on, in dealing with foreign firms that together conspire to maintain some element of protection there.

I think the Japanese understand that these things have to be changed. My hope is that they will pick up the pace, understanding the change in the political atmosphere here.

But I do think that we've accomplished a great deal. I don't think we should denigrate what we've accomplished, both we and the Japanese, because it is hard to change deeply embedded regulations and customs. We should recognize that we've made some progress, and that, in many cases, we really have solved some of these problems.

For example, access to the Tokyo Stock Exchange where, in 1984, there were no foreign members. It was expanded to 22 out of a total of 114 seats this past spring, with the addition of 16 new seats, and there will be a further 10 seats added, of which 3 or 4 will be for foreign firms.

I would say we're almost to the point in Japan on that issue where there may not be foreign firms that will continue wanting to—particularly, lately, perhaps—join the stock exchange.

So I think there, you can see a situation where real access has been created. An issue that appeared to be a total block was removed and access that is really genuine has been given.

And there are other examples.

The CHAIRMAN. Well, that's a complex answer, if I may say, respectfully. But what I get out of it, coming down to the bottom line, is that we've made some progress, we may, if I understood you right, have solved, as you would see it, half the problem. Again, to use that phrase that I think you used, half the problem is left. It's the tougher half.

How long should we anticipate that it's going to take to get that squared away, using the same approach that we're using now, and that's to chip away and cajole? Will it take us another 6 months? Another 12 months?

Give us some sense. If we're talking about 2 years, 3 years, 5 years, 10 years, then I think you really have a very lame argument

about saying that it's not time to have some greater muscle applied to this problem.

Mr. MULFORD. Well, one thing I would say is that it shouldn't take us another 6 years. So that definitely is too long. Six months is probably rather optimistic.

But without setting an exact time, I would say it certainly should be towards the shorter end of that period because first of all, now, in Japan, there are experiences of change under their belt which should allow them to move more quickly. And second, there are forces at work in Japan, which really are not forces that we generated that should encourage them to make further changes, such as the fact that in the recent market developments out there, it's quite clear that when investors liquidate assets in Japan and have liquidity, either they prefer not to hold that in yen, or they take the view that the investment options in the short-term market in Japan are not sufficiently attractive to invest in, or sufficiently available. And that ought to be a message to the Japanese to, for their own reasons, get on with the deregulation process, which really clearly now is focused on the short-end of the market.

So I think there are forces at work that could pick the pace up, in addition to the growing political interest here in action in Japan in this field.

The CHAIRMAN. When you look at our proposal, of course, it does not put in place any sanctions, unless the Treasury Department were to initiate them.

In other words, it really leaves that call in your hands and others at the Treasury Department, so that there is no mandatory requirement.

I also detect between the lines, if not on the lines, a concern that even though you folks would be the ones to make the judgment, that even that is too disconcerting, the fact that you'd have the power, if you decided to use it, but, obviously, if it never had to be taken off the shelf or if, in the best judgment of Treasury, ought not to be taken off the shelf and used, then there it would stay.

Why isn't that an entirely reasonable way to operate when the judgment, the final judgment as to whether actions were taken would be reposed in yourself and in the Secretary?

Mr. MULFORD. I think, Mr. Chairman, there's a very, very delicate call that has to be made there. And that is the call that has to do with whether or not reciprocity is the right instrument.

The fact that it could be provided in a bill like this to be used on a discretionary basis leaves open questions about who the future officials might be that would be tempted to use it, what the conditions might be.

My fear is that, though, obviously, on many occasions in the past, I have been frustrated by the lack of leverage that we have had in some of these negotiations, the reciprocity instrument is a rather dangerous instrument because of its capacity to generate retaliatory actions that actually, if they are carried out on one or both sides, do severely damage the markets on which our prosperity and global economy are so clearly based.

So, it is very much a judgmental issue. I would commend you for the careful drafting that has gone into this bill. I think it's been a

very thoughtful exercise. And as I said in my opening remarks, we share your objectives in the broad sense.

But the reciprocity issue is one on which one has to make a rather fundamental economic judgment. I personally feel that it is a dangerous road to begin to go down.

The CHAIRMAN. I want to ask two other things in relation to that before I yield to Senator Garn.

If you look at the trade position today, whether it's in financial activity or in nonfinancial-type activity, say between Japan and the United States, it would seem to me that access to the U.S. market has proven to be far more valuable to them, at least up until the present time, than access to their market has been to us.

Mr. MULFORD. In the financial business?

The CHAIRMAN. Well, taken as a whole. I'm talking about all financial activity. I'm talking about activity of being able to go in and do business.

Mr. MULFORD. I agree with that.

The CHAIRMAN. And so it seems to me that because it's stacked—we're still running a bilateral deficit somewhere in the $50 billion a year range, that that equation is stacked so strongly in their favor, that the notion that somehow or another we hurt ourselves or invite a problem if we try to move in the direction of opening up fair business opportunities for American firms there when they so profoundly have them here. I mean, it's not as if you're starting from an even balance. You're starting from being way out of kilter.

And so it seems to me that you have a situation here where we're probably late in acting now. I appreciate what you say about the chip-away approach, and that's obviously gotten us somewhere.

But in your own article in the Financial Times, in November, when you said that statutory restrictions and regulatory practice continue to be a firm barrier to full access by foreign firms to the Japanese financial services industry, you then said that situation invites congressional action and risks exhausting the U.S. Treasury's patience.

What kind of congressional action did you have in mind when you wrote that?

Mr. MULFORD. I was making in that article an observation about what I sensed was a changing political atmosphere and a broadening base of knowledge in the Congress about the relationship between developments in the financial markets and developments in the trade markets.

I think, Mr. Chairman, that you have yourself made the comment which I personally am in agreement with that, in the recent period, just in the last 2 or 3 years of the very strong yen, we have seen an expansion of Japanese financial institutions on a global basis that is very, very substantial.

When they have entered markets, they have often done in the financial business what they do in other businesses, which is to go for market share by offering highly competitive, possibly in some cases, we hear, submarket terms.

That is based, at least if they continue that for a period of time, that is based on the idea that some people have begun to look into more closely on what is thought to be a very cheap level of capital in Japan.

I have always had the view that one of the reasons we're in the business of opening the Japanese markets and getting them to liberalize their markets is that there is a very low cost of capital there.

But my point is that, as this process has taken place in recent times, people have begun to look at the financial area as one in which the Japanese institutions are engaging in sort of, in their mind, an unfair practice because they work off a cheap source of capital at home and use that, in a sense, to expand their position overseas, in much the same way that an industrial company might be accused of an unfair trading practice.

When I saw that linkage being made in the minds of people in the Congress, I then expressed the observation in the article that I thought that there was a chance that the financial area would start to move in the same direction that the trade area had moved in. And I think that would be, in a way, unfortunate because we've made very good progress in the financial area. We've accomplished a great deal. And I think the negative fall-out that comes from a really heavy confrontational approach on narrow issues, as opposed to the broad issues in the financial markets, can be damaging.

I was really warning the Japanese to get a move on it, to get on with the final 50 percent of this task because it's in their own interest to do so before the political atmosphere changes too much.

And in a sense, your bill is a reflection of that crystallization.

The CHAIRMAN. Senator Garn?

Senator GARN. Thank you, Mr. Chairman.

Mr. Mulford, I came here 15 years ago young and naive and I'm neither today.

And as I sit here and listen to your testimony, if you ever feel deja vu, or that nothing has changed, I'm sorry, but 15 years of listening to the same testimony through four Presidents, though I don't know how many Secretaries of the Treasury and Deputy Under Secretaries, or whatever, I'm convinced that your testimony comes out of the gnomes of Treasury, those people down in the bowels who it doesn't matter who you are or who the next secretary is or who the next President is. They survive, all of those, and the same pablum comes out.

If you hear frustration coming, I have heard nothing but the U.S. objection to even limited reciprocity is the risk that reciprocity would be used and retaliation would follow.

How could retaliation be worse than what we've had?

I mean, when I look at those 15 years of hearing this same testimony, and Treasury refusing to accept legislation that gives them authority, even if they don't have to use it, on the basis that you may not like who the new Secretary of the Treasury is in some future administration, how naive can we be?

Absolutely incredible. I've been lied to by the Japanese for so many years, and I lived there. I lived in Japan for a year as a young naval aviator. I have friends, still very close friends who tell me, you Americans are stupid. You continue to allow our governments to throw you a crumb here or there and drag you out, and if you don't think that that is a deliberate strategy——

I met with Nakasone personally. I can't tell you how many trips I made to these countries to talk about fairness. And when the

prime minister of a country will meet with you and say, you're right, Senator. We've got to do something about this. But you've got to understand how long it takes the Japanese to change. We can't change rapidly. We think in terms of decades and centuries, and so on.

I've heard the same speech over there, and nothing happens, except a little crumb. And then you guys come back and report a little bit of progress, and years go on. Fifteen years. And while they've been throwing us the little pablum, we continue to lose market share. Ten out of the ten biggest banks are Japanese.

When I say I don't think I'm naive, I mean, how long? A decade and a half of hearing the same speeches from Treasury and the same speeches from the Japanese and the Australians and the Koreans and the English.

Jeez. We saved them. We rebuilt their country. We gave them democracy. We've defended them to the tune of $10's of billions every year so that they could build up their own civilian economy. And I say this as one who has always been a free trader. But isn't enough enough?

And some day we decide that we're going to risk retaliation. I can't imagine what they could have done to our markets. Talk about them opening up the Tokyo stock exchange. They still haven't opened it up to anybody who can afford to buy and bid for a seat like they can on the New York Stock Exchange.

The last time I was over there, it was because they had to build a new building. And in 1 year we'll do it. So then they throw you 3 or 4 or 5 or 22 or whatever it is. If it isn't obvious to everyone that this is a deliberate strategy of delay in using the Asian mind of taking generations to do something, at least it is to me. Unless I'm the one that is naive.

And then every time we try to even give you the authority, just have a little clout to say, "hey, we don't want to use this, but if you don't move faster, we're going to," you're afraid of that.

I'm sorry, but I am just amazed. If you were the first one to tell me this, but I've listened for 15 years. Our markets are being gutted. They have 25 percent of our automobile market, and on and on and on.

But we're afraid of retaliation. If anybody had told any of us 10 years ago that they would have these market shares in all of these fields, I don't think retaliation would have looked so bad. Maybe retaliation wouldn't be so bad. Maybe we could find out.

I think we could hurt them a lot better. There is no fairness. There is no honesty in what they're doing. And they laugh at us. And if you don't think they do, maybe I should go back and replay all the visits I've had to Tokyo over the years. And, again, I say this as one who lived in their country, who used to speak a little bit of Japanese and has high regard for the Japanese people. But I certainly don't have any regard any more for the Japanese Government, and the lies and the cheating and the dishonesty and the dragging out over the years to the detriment of jobs in this country and our businesses.

So the pablum keeps coming back from our administration that if we just treat them nice and kiss them on the other cheek, that, somehow—you say 6 years. I'd be willing to bet you any amount of

money that we'll be—at least I probably won't be here. You won't be here. But somebody will be up here testifying to another banking committee, "well, we've solved 25 percent of the additional problem. They've thrown us a few more crumbs." I don't know what percentage of the market we'll have in those days.

But some day, there's got to be somebody down at Treasury that wakes up to the facts of life and looks at what has happened over the last 15 years. Maybe we ought to start saying, fine, defend yourself. Pull out our troops. Let's have a peace dividend from Japan. Defend yourself against whomever. We shouldn't continue to carry that burden.

So I'm sorry to so dump on you, but you're the accumulation of 15 years of this BS that comes out of Treasury, and it just doesn't make any sense to me that a very mild, moderate bill that gives you the authority to do something, receives, once again, the same old garbage from Treasury that you're opposed to it because you're afraid of what will happen.

What has happened? Are you proud of what has happened? And, again, I'm not singling you out. Are we proud of what has happened? Are we proud of letting anybody who can afford to, buy a seat on the New York Stock Exchange, then we brag about how they're going to give 3 or 4 more foreign seats?

And even when the laws and the rules are changed over there, you know that their practices don't, the banks are sold before the foreign banks ever find out they can buy them. It just happens to all be done. But legally, they could have been able to do it.

I mean, I'm not dealing with this academically. For 15 years, I've sat on this committee and for 15 years, I've travelled and I've discussed, but not negotiated. Legislators don't have the right to do that.

I've talked to them and there have been promises. Like I say, even at the highest level. The last time was Nakasone, and this is going to be taken care of. Even stated in the paper, a news conference after, that he took seriously what we had said.

But, boy, when I think about how little has happened in the last 4 years or so since I was over there, I'm just staggered.

Again, I apologize to you because you're just one in a number who is following the same Treasury line. It doesn't matter whether you've got a Democrat or a Republican President or who the Secretaries are. The same policy continues while this country continues to be ripped off in manufacturing, ripped off in financial services, losing jobs and our competitive position around the world.

Again, I don't know how retaliation could be any worse. I can remember this same Treasury Department, after Toshiba ripped this country off, and I don't know how much they cost us in terms of defending against the new collider submarines. And they even opposed my bill to punish Toshiba when it was a national security issue.

A Reagan administration. That's the one that really blows my mind. A Ronald Reagan administration opposing penalties on Toshiba, who sold very highly sensitive milling machines to the Soviet Union.

So I don't have any questions because I know what the answers will be.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Garn. [Laughter.]

I think Senator Garn's comments express, in their own way, frustrations that I hear increasingly from members throughout the Senate of both parties. The United States, I think traditionally, has been so insistent on fairness in our trading and commercial relationships, that it's the way we think. And when we run into something that is patently unfair and doesn't change a very substantial degree, I think it builds huge frustrations.

Senator GARN. Mr. Chairman, let me make one more comment.

I think this testimony today has given me the incentive. We ought to work harder and make this bill the highest priority to pass that we possibly can and let them veto it if they want to.

But I'm very serious. I'm not trying to be funny about it. I think it's time because I can remember—maybe they were trying to make me feel good—but in Australia, they told me that they allowed three or four more banks after the Martin Commission report because of the threat of my legislation.

Whether that was true or not, I don't know. But if the threat of legislation brings them around, let's pass this and let's put the monkey on the administration's back to come up with the pablum and veto it if they want. But let's make it really a high priority, not just talk about it. Let's pass it.

The CHAIRMAN. Sounds good to me. Did you want to say something?

Mr. MULFORD. Well, let me just say that I do share many of Senator Garn's frustrations, and wouldn't contest many of the points that you made.

I do believe that we have done a substantially better job in recent years and that the accomplishments are not just crumbs. I think there are very substantial changes taking place in Japan, some of which are giving us better access, and I think we've accomplished things there. But I also think that we've made substantial progress in changing Japan's markets internally, which is an important thing to do as Japan increasingly joins the world.

I also think, Senator, that there is a cost—and I fight the frustration myself that you have just expressed. But there is a cost if one of the effects of our actions, whatever those actions might be, is to substantially damage or diminish our own market to our own disadvantage.

And I think that that's an important thing to bear in mind. I know you mentioned that. But it is, it seems to me, part of a balanced picture.

Finally, at least as long as I've been assistant secretary and under secretary, my staff doesn't produce stuff that I just come up and read. If that were the case, I would quietly excuse myself from appearing.

I want you to feel that when I come up to testify, I try to get as good a piece of testimony as possible, with all the other demands that are on me. And particularly in the question and answer period, that I attempt to make honest and full answers to your questions.

I know you didn't make those comments personally about me, but I do think that there is a more serious and constructive, and I think effective, approach.

It isn't enough, and I've told the Japanese some of the same things that you've said, and I agree with what you've said about the timing. They do not have 6 years to wait around.

I did say I don't think they have to complete the job in 6 months.

Senator GARN. But I was told that 15 years ago. That's why my frustration.

Mr. MULFORD. I understand that.

Senator GARN. I was patient. In 5 years or 6 years, I would have been pleased. But 15? That's where my frustration comes.

Mr. MULFORD. I'm not arguing with you on that. I think the Japanese have got to take notice of views of the type you've expressed.

Senator GARN. You see, I agree with you on your general philosophy. I've swallowed that most of these years, too, when you talk about, we don't want to damage our own markets. But our markets have been damaged. That is the point that I am making.

They have been damaged and we have been hurt in international competition, and we are continuing to lose that game.

So this is the frustration of 15 years that's coming out today. We don't have time to wait another 5 or 6 years. We'll be so far behind the power curve in another 5 or 6 years, then they can sit back and make changes after they've gotten their market share and it's more difficult to compete.

That's been their game all along. They stall you while they get market share and then they're willing to make concessions and we pat them on the head and say, thank you for being so nice.

You'll get changes when they're satisfied with their market share. That's the game they're playing. It's very deliberate. Very deliberate.

Mr. MULFORD. I have yet really to pat a Japanese head, I think. But we have at least felt that they've tried to make some changes and we've given them some credit.

But, basically, I think they have got a very, very long way to go.

Senator GARN. My time is up. But I heard about all the things that would happen in retaliation from the Toshiba amendment. It didn't occur. Most of the threats I've heard have not occurred. And some changes were made as a result of that amendment. They made some dramatic changes in their export control laws. The Diet made some changes that they did not make until the Toshiba amendment occurred.

I think that is an example of where some tough legislation did not produce retaliation; it produced change that I don't think would have occurred today without that amendment.

Mr. MULFORD. I think that you're right. The Japanese have a tendency to make their compromises under enormous duress. And that feeds the strategy of putting that pressure on them, instead of gaining them the advantages that I think they seek.

And I think that that's a serious problem in their negotiating position on almost everything I've had any contact with.

The CHAIRMAN. Senator Shelby, let me say to you and Senator Sarbanes, you're next in the order. And I'm going to suggest that you make any initial opening comments you want to make and

then go right into your question period, and then we'll do the same with Senator Sarbanes.

Senator SHELBY. Mr. Chairman, thank you. I will ask unanimous consent that my opening statement be made part of the record, and I will go right into some comments.

The CHAIRMAN. Without objection.

Senator SHELBY. Mr. Secretary——

Senator SARBANES. Well——

The CHAIRMAN. Excuse me. Senator Sarbanes, did you want to——

Senator SARBANES. I wonder if one could make a statement if one can't stay because I'm in that posture here this morning.

Senator SHELBY. I will yield to the Senator.

The CHAIRMAN. Very good. Senator Shelby has yielded for that purpose.

Senator Sarbanes?

Senator SARBANES. Well, Mr. Chairman, I'm sorry I'm not going to be able to stay for the hearing. But I'm caught in a situation we all face, obviously, from time to time of a competing concern.

I just simply wanted to make a short opening statement.

The CHAIRMAN. Please do.

OPENING STATEMENT OF SENATOR SARBANES

Senator SARBANES. First of all, I've been prompted to come, and I say this with all apologies to David Mulford, not so much by the panel that's before us, I have to admit, but by the necessity of obtaining a quorum in order to approve the two nominees who will finally fill the public positions on the Resolution Trust Board.

I again want to commend you for the quick way in which you've had the committee move on those nominees, once they were gotten here by the administration. It took an incredibly long period of time to fill those spots, but I am pleased that they're on the way to being filled.

But I must again register my very deep concern about the amount of time it's taken us to get to this point with respect to the nominees.

And I just on the hearing before us want to comment that I understand the frustration of the members of this committee on this issue and I share much of it myself. I think it's very important that the parties with whom we are negotiating abroad that Secretary Mulford is dealing with understand that and understand the possibility of congressional action in these matters.

I happen to think that the under secretary is a pretty good negotiator, and so I don't really fault him. But I know he's up against a situation in which other nations are trying in one way or another to work this system to their advantage.

The Congress, I think, is increasingly onto that game, isn't going to sit still for it, as I think has been expressed very clearly by some of my colleagues. And hopefully, the knowledge of that attitude here on the part of the Congress will be helpful to the under secretary in some of the negotiations that he's engaged in.

We want those negotiations to succeed and we want the administration to take a very firm and clear position because we think that we've been taken advantage of.

We don't think the thing has worked fairly. We think it's been manipulated by others to their narrow interest. And at least I, for one, want him to come out of this hearing understanding that there's a very strong congressional support for a very hard negotiating position on the part of the administration.

So we're pressing you to press harder. If we don't get a response, I think we'll get action here.

I was listening to some of Senator Garn's questioning. But I think the secretary is pushing pretty hard. Well, we're prepared to back you to push even harder, and those with whom you're negotiating ought to understand what the attitude is that exists here in the Congress, which can be reflected in any number of ways in terms of the U.S. relationship with these countries.

So I thank my colleague. I appreciate it very much.

Mr. MULFORD. Thank you.

The CHAIRMAN. Senator Shelby. Senator Graham has come in. I saw Senator Heinz a moment ago. I guess he has stepped out.

Senator Graham, I had called on Senator Shelby to make his opening comments and he was next in the line of questioning.

Do you have any particular time constraint if he proceeds now before you make your opening comments?

Senator GRAHAM. No, Mr. Chairman.

The CHAIRMAN. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

I just want to pick up on something that Senator Garn was talking about. He's been here 15 years. This is my fourth year on this committee.

But I've seen a glacial pace, Mr. Secretary, and I'm not attributing it all to you. I don't want to attribute a lot of it, or hardly any, to you.

But is this administration going to wake up to the fact that we're playing by the Japanese rules and no other rules? We've moved from industrial products, and they're still there, where they have targeted markets, to financial products, to financial stuff.

The banks, as we all know, their banks are the largest in the world. They're going to be in the credit card business, as you well know, in just a little while here in this country. They're already targeting the area. And once they come into an area, they target a market. They want market share, and they drive us out.

I suppose the real question is when are we, and this administration, going to wake up to the fact—they've outsmarted us, they've outmaneuvered us. Will we ever wake up that the Japanese have eaten our lunch. They're buying our factories. They're buying our banks. They're going to have their presence here.

They've hired, Mr. Secretary, as you well know, some of the most powerful lobbyists, some former members of Congress, former trade representatives, dealing in trade, probably in Treasury. I don't know. I don't have the list. But when the Toshiba affair came up, I was initiated very well with what we call the Japanese lobby in the United States, because I joined Senator Garn with that bill. We worked it.

I had spent 8 years in the House on the Energy and Commerce Committee. I had never seen the intensity of the Toshiba or the whole Japanese lobby in America, hiring by the hundreds, probably—nobody will never know how many millions of dollars were spent on that lobby effort—to get our own Congress to vote against our own national interest, our own interest.

That's the bottom line. Everybody knows this.

Were they successful? To some degree, they were. Senator Garn, I was involved in it, and several. We were able to get some legislation through.

Now we want it enforced. But that's just a small side of this whole thing. I guess the bottom line—when will the administration wake up to the fact that the Japanese are playing by only their rules. They're not ever going to play by our rules. They respect one thing—whether it's economic power, military force, or so forth.

I wish the administration well. But you're not doing any better, your administration, than the previous administration, to this Senator's eyes.

Where are we going? The man in the street, whether he's in my home State of Alabama, or whether he's in Kansas or Montana or Maine, they have awakened to the fact that the competition of the Japanese is pervasive in this country. It's real. It's not going to go away. But when is the administration going to wake up to this?

When are you really going to get tough? I don't believe you will.

Mr. MULFORD. Well, let me——

Senator SHELBY. Sure. I'd like to hear your comments.

STATEMENT BY SENATOR RICHARD SHELBY

Senator SHELBY. Mr. Chairman, I would like to commend you for introducing this legislation. I believe that the time has come for the United States to use more leverage in negotiating for equal access in foreign markets.

I have read through the witnesses' testimony and I particularly like Mr. Pauli's points on how to liberalize the Japanese market. He advocates the necessity of negotiating from a position of strength. In his words, "either you negotiate from a position of power or there is no negotiation at all. You end up asking favors."

Mr. Chairman, for too long we have been in a position of asking favors. For too long we have relied on the "good example" policy, hoping that if we set a shining example for our trading partners, they will soon follow suit, out of gratitude and courtesy.

However, in the meantime, the Japanese are gaining significant market share in this country. The strength of the yen and the low cost of the Japanese deposit base have enabled the Japanese to export capital abroad. From a macroeconomic perspective, this is good. American business needs access to capital and it doesn't matter who provides that capital. However, that is not to say that American financial institutions are not entitled to the same generous treatment abroad.

I support this effort to open foreign markets. Our trade negotiators and the Department of the Treasury can continue to speak softly in demanding market access but the passage of this legislation will give them a big stick to back up their words. I commend

you for your efforts in this area and would like to see us consider this measure on an expedited schedule.

Thank you, Mr. Chairman.

Mr. MULFORD. I'm happy to comment on that.

Senator SHELBY. And they weren't all directed at you, personally.

Mr. MULFORD. I understand that. But I like to speak rather personally——

Senator SHELBY. Sure.

Mr. MULFORD [continuing]. Because that's been my experience.

I think the administration woke up, as you put it, on the financial issue 6 years ago, when a special effort was made to attack three problems with Japan. First was the internationalization of the yen; that is to say, to try to accomplish a broader usage of the yen world-wide so that it would more accurately reflect the underlying economic strength of Japan.

That, effectively, was accomplished. But there's a negative side to that and that is that as the yen strengthened, the dollar weakened. They were able to make their presence more clearly felt in this country, which has had political implications that you've mentioned.

Senator SHELBY. But also, economic implications.

Mr. MULFORD. And economic implications, that's correct.

But that flowed from that original attempt because, from an exchange rate standpoint at that point, the dollar was very strong and the yen was substantially undervalued, and we were heavily criticized for that.

Now the thing has reversed, to some extent, and there's also criticism on that score by, presumably, other people.

The second issue is access.

We've made real progress on access. I think if you ask the U.S. financial community, they would agree that in the last 5 or 6 years, there's been very substantial improvement in access.

And finally, we attacked what I think is really the fundamental problem, which is the structure and regulation of the Japanese financial and capital market.

I must tell you that in the early years, I didn't get much attention on this because it was a long way away. What has really focused attention and, obviously, causes you to make these observations, is that, as the effects, partly of our success and partly of other changes, of Japanese direct investment in the United States have taken place, it's become a more obvious issue.

But I don't think that changes the fact that we, and I, in particular, still have a very strong commitment to trying to finish this job. And as I said before you came in, we're 50 percent there, but the last 50 percent is going to be harder politically.

But there are other forces at work that will help us.

Senator SHELBY. Why? Why harder politically? And harder for whom?

Mr. MULFORD. For the Japanese and for us to accomplish because we are now saying to them, you've made a number of changes. You've gotten down to the hard, bedrock of the problem. The bedrock of the problem, unfortunately, means that you've got to change your laws. You have got to ensure better access where it's absent. You have got to allow the entry of financial products intro-

duced into your market by firms that have developed them overseas, but you're preventing the entry of that product into your market.

You've got to give Japanese investors better investment opportunities, so that when we see a situation like today, where they are converting assets to liquidity, there are short-term investment options there for the Japanese people.

They're obviously selling the yen because they're not satisfied with the domestic investment opportunities in the short end of the market.

And these things, it seems to me, will continue to work for change. But we have got to be tough and persistent. I believe we have been, although I recognize the frustration that is felt in this committee, which I share myself.

Senator SHELBY. Mr. Secretary, what percentage of the Japanese trades in good and services is with the United States? Roughly. You can furnish the exact figure for the record.

Mr. MULFORD. Yes. I can't offhand remember that number.

Senator SHELBY. Is it close to half?

Mr. MULFORD. Probably, yes. For the record in 1989, 33.4 percent of Japanese exports were to the United States market, and 22.8 percent of Japanese imports came from the United States. We will not have figures for trade in services for 1989 for another month.

Senator SHELBY. So if we are trading with the Japanese in goods and services for over half or around half of their output or their exports, wouldn't it seem logical that we would have a lot of clout, you know, that we're their customer, they're dependent on us for so much? And have we really used that clout?

Obviously, not.

Mr. MULFORD. I think we have used that clout. Maybe not as effectively and fully as we could have, in some cases. But I think it's been used. But I would point out that——

Senator SHELBY. It hasn't worked, if we've used it.

Mr. MULFORD. I think it has worked, in some cases. But I think the problem is that it's——

Senator SHELBY. It's worked and they're still eating our lunch. You're saying it's worked, and you know it's not working.

Mr. MULFORD. I think it has worked in many cases, but I think that one of the problems is that you can use that leverage to your own disadvantage, if you're not careful.

Senator SHELBY. Tell that to the American worker.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Shelby.

Senator Graham?

Senator GRAHAM. Thank you, Mr. Chairman. I have an opening statement which I'd like to file for the record.

The CHAIRMAN. We'll make it part of the record.

OPENING STATEMENT OF SENATOR BOB GRAHAM

Senator GRAHAM. I congratulate you on holding today's hearing on the extent to which U.S. financial firms are accorded "National Treatment" in other financial markets. And in particular, S. 2028, which would further refine the national treatment standard and

strengthen Treasury's ability to see it adopted as the basis for competitive access to foreign banking and securities markets in their discussions with other countries.

In 1988 I traveled to South America. During one of my stops on this trip a U.S. bank shared its concerns with me about the denial of national treatment it was receiving in a particular country. This bank was trying to expand its deposit base and was not being allowed to receive the same expansion capacity as the national banks were allowed. This bank was looking for answers that were not easy to find and 3 years later I am not aware of any changes in the national treatment policy in this country.

As of December 1, 1990, the Secretary of the Treasury must report to Congress on the extent to which foreign countries deny national treatment to U.S. banks securities firms. Also the Treasury must report on the efforts the United States has undertaken to eliminate this discrimination. American financial institutions are meeting national treatment problems around the world. I would hope Treasury's report to Congress in December this year will have good news for U.S. financial institutions. Mr. Chairman, I look forward to the testimony today.

In 1988, I visited three countries in Latin America as a representative of the International Economic Subcommittee of this committee.

While we were there, we heard considerable concern about the treatment which was being accorded U.S. financial institutions. We've corresponded about those concerns subsequent to that trip.

Mr. Mulford, from your perspective, what is the driving force behind Latin American countries' unwillingness to afford national treatment to U.S. financial institutions?

What are their apprehensions?

Mr. MULFORD. Their apprehension is that they, on that business, I mean, on that particular issue, they're protectionists and they're worried about upsetting and damaging their own cozy market.

Senator GRAHAM. Is there anything that the United States can do to deal with those concerns or to override those concerns by putting them in a larger perspective of U.S./specific country, economic relationships?

Mr. MULFORD. That is an issue which we constantly take up with the countries in our other contacts. But probably the most effective force for change in recent years has been the conditions that have been imposed or negotiated as the countries have approached institutions like the World Bank, for financial sector loans, where there has been some progress in laying down conditions that have provided some measure of opening.

But the Latin countries are very, very far behind, to their own detriment. This is, for us, a very high priority issue on which we keep banging with them.

We have not opened up financial market talks as we've done with Japan and Korea. I would say partly because we simply don't have the manpower and time to conduct those kinds of negotiations individually with every single country.

We've used the National Treatment Study as a source of pressure to study the situation, highlight it, and indicate to the country

what sort of assessment we're going to make. And that has produced movement. But we have a tremendous gap to close there.

These countries are really diminishing their own economic capacity by pursuing a closed market approach.

Senator GRAHAM. In the recent negotiations on debt with Mexico and Venezuela, was this issue part of that negotiation? If so, what was the resolution? And how do we plan on monitoring the implementation of the resolution?

Mr. MULFORD. In our discussions with Mexico, the need to open their market, in general, was pressed very hard. Indeed, it's easy to measure the results up till now because they have made major efforts and have changed very substantially their investment regime. They have privatized a number of companies, and in privatizing them, have included foreign ownership in the telephone company, copper company, both airlines.

They are committed to continuing to move in this direction.

In the financial field, they face politically a very difficult problem because, as you remember, they nationalized the banks some years ago, so that they have to tread rather carefully on that issue.

But I have no doubt that, in due course, they will address that issue. I don't myself, speaking personally, believe it will be too long before they do so.

Senator GRAHAM. Is the answer in terms of was this part of the recent debt negotiation with Mexico that this was not part of that discussion?

Mr. MULFORD. The issue of policies, in general, such as the question of opening to investment, the things that I've mentioned, as well as other issues, have been addressed in the debt process by the World Bank, the IMF, the Treasury and its contacts, and the commercial banks have raised the issue.

So, yes, it's been an integral part of the process of negotiation.

We have not, in the Treasury, said, at any given time, you have to change this law or we won't meet with you, or something like that. But we've made it very, very clear that this is for us an important part of the cooperative process on the debt strategy.

Senator GRAHAM. Venezuela has been another country of concern relative to its policies vis-a-vis U.S. financial institutions.

In the debt negotiations with Venezuela, was the question of national treatment of U.S. financial institutions a factor?

Mr. MULFORD. It was, in the same way as in Mexico. It was part of the overall atmosphere. I personally raised the issue with the President of Venezuela when I met with him last August, and indicated the importance that we attach to this.

It is an odd point in Venezuela that the financial area is under the jurisdiction not of the Ministry of Finance, but another ministry. We have written to them. We have had some discussions. But, again, not a formal negotiating team approach.

I personally think that there are changes coming in these countries, partly because they understand that to make their economic recovery, they need to make these changes. Not just in the financial area, but in welcoming foreign capital in general.

It's a slow process, but it is happening.

Senator GRAHAM. I apologize for arriving late, but in the specific case of Mexico and Venezuela, how would you assess the potential

impact of the legislation that has been filed by the Senators Riegle and Garn?

Mr. MULFORD. You mean if the legislation were to be passed, despite the administration's position?

I think it would have some effect.

Senator GRAHAM. Towards according treatment to U.S. financial institutions in those countries, more analogous to that granted to national?

Mr. MULFORD. I think it would make some contribution to the opening of those markets. I think it's hard to assess what the cost to us would be in terms of actually utilizing reciprocity provisions that might be in there, not vis-a-vis just those countries, but, in general, the approach we take to our own market.

There, obviously, we believe, is a cost there that could be very high in terms of damage to our market over time.

But, in the case of those two countries, I think the effect would be to cause them to open more quickly.

Senator GRAHAM. Thank you.

The CHAIRMAN. Thank you, Senator Graham.

Let me just say before we go any further, we have four other witnesses that will follow Mr. Mulford. And so, I want to give every member another opportunity to raise issues with Mr. Mulford that they may wish.

I'm only going to make one point because I want it crystal clear in the record and for all that are following this, that our bill is a reciprocal national treatment bill. It is not a reciprocity bill. And that's a very important distinction.

We're saying that we feel that American institutions competing in foreign countries ought to have the same rights to operate within that country that native institutions in those countries have. We allow that kind of national treatment to foreign institutions here in the United States—they come in here on an equal footing with American players.

Reciprocal national treatment is about as fundamental, I think, as any concept of fairness or fair play. I mean, I don't know what better constitutes a fair definition of equity and some kind of a proper balance.

And that's what this is about. That's what this bill is about.

And we've gotten there in very measured steps over a period of time. As Senator Garn said earlier, this is not an extreme measure. I mean, this is the kind of measure that is a product of great thought, great patience. And now, a feeling that we're just not seeing the changes that we need to see.

And the world is moving. You know, the thing that distresses me as I watch what the Europeans are doing here, the Europeans are very clear on this issue. They understand the fact that, as they make their changes, and are prepared to allow competition on an equal footing within their system, they're not about to tolerate the kind of inequity by other trading nations that's the focus of our effort here.

And my sense is they intend to be very tough about it. And my hat's off to them. They've been tough about it, country-by-country, with respect to other kinds of products quite different than financial services. But when you yourself testify that that's the direction

that the world is going, but, somehow or another, we can't move along as rapidly as others are, I just don't think that's sufficient.

I don't say that with any disrespect to you because, as you know from my initial comments, I have great regard for you and regard for the job that you're endeavoring to do.

But this is a reciprocal national treatment bill. No one should lose sight of that.

Senator Garn?

Senator GARN. Thank you, Mr. Chairman. Mr. Mulford, as I sat here since my opening remarks, my staff brought me the hearing record from September of 1984, on a previous bill that I talked about. I've been thumbing through it and it confirms even more than my 6 year old memory.

Your testimony may have been entirely independent. But if you read this, we could almost put this in the record of the hearing today. Six years have passed, but it's absolutely remarkable to me in reading through it the testimony from Secretary Regan.

And just so that those who have forgotten—I'd even forgotten how mild my bill was in 1984, and yet, opposed. I can read you the whole thing. The whole bill is only one paragraph:

> In acting on any application to establish a Federal branch or agency, the Comptroller shall take into account the effects of the proposal on competition of the domestic and foreign commerce of the United States, the financial, managerial resources and future prospects of the applicant foreign bank and the branch or agency, whether or not United States banks are permitted to conduct business in the home country of the applicant and the convenience and needs of the community to be served.

That's all. It said the comptroller should take into consideration these facts, and that was opposed.

And then when I look at the explosion of intrusion into our markets in that 6 year period, and then I'm told again that we're making progress.

I think maybe you can understand why I would feel the way I do, because I had forgotten myself. Here is a reprint of a Business Week article in the testimony of May 14, 1984. And to quote just briefly from it—the headline is:

> A BILL THAT'S PACKING A PUNCH BEFORE IT PASSES.
>
> Rarely has a bill that has not even reached the Senate floor created as much turmoil around the world as Senator Jake Garn's proposal to treat foreign banks in the United States much the way American banks are treated overseas. The name of the game is reciprocity. The bill would simply authorize the Comptroller of the Currency to consider reciprocity, among other factors—again, consider, among other factors—when examining applications by a foreign bank to establish a federally chartered branch or agency. The Australian government may allow foreign banks to own up to 50 percent of 4 to 6 full-service banks yet to be created.

It goes on that even the Japanese are bending. Two weeks later, in Washington, Japanese officials agreed to permit foreign banks to underwrite and sell government bonds over the counter, and so on.

It summarizes that, of course, this is just what Garn has in mind. In fact, if more countries ease their restrictions on U.S. banks, Garn might withdraw his bill. If so, it would stand in the annals of Congress as a rare piece of legislation that had its full effect without ever being enacted.

Now, when you've gone through this for a decade and a half, and in 6 years—and I'm not questioning your sincerity. You work very hard and negotiate very hard—but the situation has worsened.

That article was wrong. It makes me feel good to have a nice article about how much impact I had, but it was absolutely wrong. It had virtually no impact in the long-term scheme of things. It didn't pass, and they forgot about it.

And I still happen to think if the Comptroller could at least consider those factors, that could have made a difference. And if they want to retaliate against us when we tell one of our Government officials, he can consider this as a factor, or you can use this new legislation, are we really that timid? Are we so frightened by the Japanese that we have no courage at all, other than for you to go jawbone?

There's also comments about the effectiveness of jawboning. You may some late night when you can't go to sleep want to read this, and others that I can supply you with, and you'll be amazed about how nothing has changed, except it's 6 years later.

I rest my case, Mr. Chairman.

The CHAIRMAN. Senator Shelby?

Senator SHELBY. Mr. Chairman, I just want to say one more thing.

I was not here when the record was made, but I appreciate Senator Garn going back, or his staff going back, and getting that, because it's the same old story, Mr. Secretary, that we hear here.

You say that we've made progress. But I say, if we made it, we've gone back in other areas. Just wake the administration up to reality.

The CHAIRMAN. Senator Graham?

Senator GRAHAM. No further questions.

The CHAIRMAN. Mr. Mulford, we'll have some questions for the record today and we appreciate your coming.

I don't want to finish. If you've got something that you want to say as a final comment.

Mr. MULFORD. I would like to make a couple of——

The CHAIRMAN. Let's have order, please.

Mr. MULFORD. I'd just like to make a couple of points in response to what's been said here.

First of all, on the reciprocity issue, it should be clearly underlined that the United States' position aims at achieving equality of competitive opportunity. That is involved in the national treatment concept.

We don't have equality of competitive opportunity today in Japan, for example, or in Venezuela, or Mexico. But we are seeking to come closer to that.

The trouble with reciprocity is not so much that—and, by the way, reciprocity is a very complex, semantic problem—but it is not so much the granting of the possible authority that would bring retaliation, I think. It is the possible use of that authority for specific cases that then become generalized and do have an effect on our market.

Because reciprocity—one of the most difficult things about that concept is that, if you carry it to its logical conclusion. And if you have the largest financial market in the world, you actually have

to have somebody who says, well, banks from this country do this for us, so we only do this for them here.

So these banks in the United States from Australia do these six things, but the banks from Mexico do seven things and the ones from Germany do 25 things because they let us do 25 things.

The CHAIRMAN. Yes. But, we're not asserting that in this bill. You know that.

Mr. MULFORD. I understand that. I understand that. But the reciprocity issue gets off into that sort of area.

The CHAIRMAN. Well, let's not inject it. Why inject it, then?

That's not what we're asking for. That fuzzes it up. I mean, if you want to go slay that dragon, then that's maybe a different bill some other place. That's not what we're proposing.

Mr. MULFORD. I understand you're talking about reciprocal national treatment. And I'm making a distinction which I think is important because the words reciprocity and reciprocal national treatment have both been used here this morning.

The CHAIRMAN. But they're very different.

Mr. MULFORD. They're very different. That's exactly my point. And the reciprocal national treatment point, it is different. It is what the EC has finished up with in its directive, partly because of our negotiations with them which brought them away from reciprocity towards reciprocal national treatment.

On the question raised by Senator Shelby, I think that you should seek the views of the U.S. financial community about whether or not progress has been made or not in Japan. And although there may be, in some sense, a setback in other areas, in your view, and it's always possible to find those things, I suppose——

Senator SHELBY. I don't think it's just my view, Mr. Secretary.

Mr. MULFORD. Well, I think, Senator, that you would find that the banking industry feels a lot of progress has been made. I say so, but don't take my word for it. Ask them.

And on the question of the American worker which you mentioned, we have to recognize that a lot of American workers work for foreign companies. They're glad to have that job.

So we want to keep our market open, too. We don't want to cut our own wrists on this sort of business.

The CHAIRMAN. If I may just say, and Senator Shelby certainly is entitled to respond as you've addressed that to him.

Senator SHELBY. I will.

The CHAIRMAN. There are a lot of lawyers in this town that fall into that category of working for foreign employers. And it's part of the problem, if I may say so. There's a lot of work being generated in this town in the legal community precisely on this issue to maintain the inequities, if I may say.

Senator SHELBY. Mr. Chairman, I'll be brief. I know we've got another panel.

Mr. Secretary, I realize there's been progress. But as I said earlier, I think it's a glacial progress. And as we make some progress in this area, we're going to go back in others. This has been the history of it. It's been the history, not just of this administration, but the previous administration, and probably the one before that.

What I'm asking, or trying to get at, is when is this administration going to wake up to reality? I don't think you've used your aces in this battle. I don't believe you have. I think you've been timid, this administration and the last administration. You didn't want to ruffle the Japanese Government and the Japanese feelings.

But when we're their number one trading partner, we've got some power we haven't used. And I believe that's a strong perception in American—mainstream America. Maybe that's not the perception on Wall Street. Maybe that's not the perception with some of our money-center banks.

But it's the perception in main town America, and I believe it's the reality, too.

Senator GARN. Mr. Chairman, if I could just——

The CHAIRMAN. Yes. Let me just see if Senator Graham has something, and we'll come right back to you.

Senator GRAHAM. No further questions.

The CHAIRMAN. Senator Garn?

Senator GARN. I'll just make one closing comment. And I want to make very clear that my remarks are not directed at you personally because I think you're aware of the high regard that I have for you and your ability.

But if we can't even pass bills that give discretionary authority that national treatment, reciprocal national treatment will be considered in these things, then let the message go out of here loud and clear that this free trader is not going to be a free trader any more. There will be more Toshiba amendments. There will be more getting back into reciprocity. And I fully understand the difference.

If somebody won't send messages, this Senator and this committee will. And we'll start some real punitive legislation that obviously would not become law as long as administrations are around.

But I think it's time that Congress started sending some strong, specific messages. If we can't pass this one, then we'll start talking about much tougher legislation. And maybe we can help you in your negotiations.

You can be the good cop and we'll be the bad cop. And I'll be a very bad cop. [Laughter.]

The CHAIRMAN. Mr. Mulford, thank you.

Mr. MULFORD. I'd like to thank the committee for having me up here today. Thank you very much, indeed.

The CHAIRMAN. Well, we appreciate your coming and we appreciate the frankness of the exchange. And we always welcome having you.

Mr. MULFORD. Thank you very much.

The CHAIRMAN. Before we invite our next panel of witnesses to the table, I have statements from Senators Sasser, Sanford and Dixon for insertion in the record.

STATEMENT BY SENATOR JIM SASSER

Senator SASSER. Mr. Chairman, your leadership in both the drafting of the Fair Trade in Financial Services Act of 1990 and the focus given to this hearing today are to be commended. The issue of our competitive status overseas is one of the most pressing issues faced by the Banking Committee and the 101st Congress. We have

long enjoyed a preeminent position in financial services; we cannot afford to give up this position.

In 1978, American banks controlled the largest share of the international banking market and we had two of the three largest banks in the world. Today, the largest U.S. bank is the 24th largest bank in the world. It would seem that we are losing the battle for leadership in financial services while we have the greatest capital market in the world.

Our financial services industry and innovative financial products are some of the strongest products our Nation has to offer. Everywhere we turn, it seems that we are losing our competitive edge and operating at a trade deficit. This is one area where we can hold our own and excel—if our companies can gain foreign market access.

I think it is particularly imporant that the Fair Trade in Financial Services Act specifies that "effective market access" requires equality of competitive opportunity not just in statute [de jure], but in actual practice [de facto]. This is important because many countries do not have statutes on the books which prohibit foreign investment or operations, but their financial structure and licensing procedures effectively preclude the operation of branches of foreign banks.

I look forward to the testimony from our desitinguished panel of witnesses.

OPENING STATEMENT OF SENATOR TERRY SANFORD

Senator SANFORD. Mr. Chairman, I would like to thank our witnesses, the Honorable David C. Mulford, David Silver, Eric Hayden, Charles Kim, and Gunter Pauli for being here today to offer testimony on the competitive position of U.S. financial institutions.

For the first time in our history, the United States is threatened by the possibility of losing our premier position in the world marketplace. Over the past two decades we have watched the health of our major businesses and industries decline. Growing international competitiveness has placed pressure on both industries and Government to ensure fair access to world markets, on which we have become so dependent.

We can no longer rely on the strength of our economy to ensure our dominance in the world marketplace. It is becoming clear that to be competitive and to emerge as leaders, our institutions will need to have not only access but the ability to supply a full range of services in foreign markets.

S. 2028, introduced by Chairman Reigle and other members of our committee, undertakes to modernize the regualtions governing our financial institutions to ensure our access to foreign markets.

I look forward to the testimony of our witnesses today, and will listen earnestly to their discussion of the legislation before us.

STATEMENT OF SENATOR ALAN J. DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the Senate Banking Committee considers S. 2028, the Fair Trade in Financial Service Act of 1990. I am proud to have joined you, Mr. Chairman, the distinguished ranking Republican

member, and 8 other members of this committee in cosponsoring this important piece of legislation.

I am concernced that American financial institutions are currently losing market share—both domestically and overseas. I believe that American banks have been competitively disadvantaged in Japanese financial markets. And, any weakness of American banks abroad makes more difficult the efforts of American firms to promote exports.

This bill is a good idea. I support it and think we should approve it in committee and send it to the floor in short order.

In fact, I think that the Fair Trade in Financial Services Act is such a good idea that I have decided to introduce parallel national treatment provisions for options and futures firms and exchanges.

In an article in the Financial Times one of our witnesses today, Under Secretary Mulford, wrote:

> The Chief brakes on further progress are the laws, regulations, and practices which . . . impede the entry of innovative foreign products and services to the Japanese market. . . For example, the Chicago mercantile exchange has been delayed in obtaining Japanese approval for its globex electronic trading system.

Well, I agree with what Mr. Mulford wrote and I intend to do something about it.

Just as U.S. banks and securities firms deserve national treatment and effective market access in foreign countries—because we provide these opportunities to their firms—so do our futures and options firms and exchanges. I believe we should provide Mr. Mulford and others at Treasury with more effective negotiating tools so that American firms will be treated fairly. The Fair Trade in Financial Service Act—and the parallel amendment I intend to offer to it—will accomplish that goal.

The CHAIRMAN. Mr. Hayden, Mr. Silver, Mr. Kim, Mr. Pauli will you come forward.

[Pause.]

The CHAIRMAN. We'll wait just a moment until the room clears. I think we've lost a little bit of the lobbying community moving out the door.

Let me welcome all of you. Mr. Hayden is president of the Investors Bank and Trust Company in Boston, Massachusetts.

David Silver is the president of the Investment Company Institute here in Washington, DC.

Charles Kim is the president of the California Center Bank in Los Angeles, here representing the Independent Bankers Association of America.

And Gunter Pauli is the chief executive officer of European Service Industries Forum from Belgium.

We're very pleased to have all of you. I'm going to start by having those of you who represent associations to begin. So we'll go in a particular order here. I'm going to start with you, Mr. Silver.

Let me say to all of you that we'll make your statements a part of the record. I'd like to ask you to summarize as much as possible. I'd like you to stay within the 7 minutes that we've suggested. If you can do it in less than that, fine, because we'd like to have time to go back and forth with you.

So, with that, we'll start with you, Mr. Silver, and we'd be pleased to hear from you now.

STATEMENT OF DAVID SILVER, PRESIDENT, INVESTMENT CO. INSTITUTE, WASHINGTON, DC

Mr. SILVER. Thank you, Mr. Chairman. I do have a longer statement for the record.

I am David Silver, president of the Investment Company Institute. I am here today to express our industry's support for S. 2028. This support is based on long professional and, I may say, personal experience in the field of international securities regulation.

The Investment Company Institute has enjoyed cordial relationships with our overseas counterparts for some decades. The Institute has also been active in seeking to open foreign markets to our member mutual funds. Indeed, as far back as 1971, we reached an agreement with the German banking authorities which led to the entry of American mutual funds into West Germany.

In recent years, the pace of our activities have quickened, as internationalization has proceeded rapidly.

In the last several years, we have had contact with a number of overseas trade groups and foreign regulatory authorities. I have personally visited industry and regulatory officials in Australia, Japan, India, the United Kingdom, Germany and Canada.

Since 1987, we have been engaged in intense discussions with the pan-European mutual fund trade group to develop a framework for cross-border sales of U.S. funds and European funds.

These contacts have been valuable, since we have amassed a great deal of information about regulation and markets overseas.

Thus, when considering issues of reciprocal entry and market access, we are in a good position to separate real concerns for investor protection from the chaff of protectionism.

Our experience also confirms that our system of securities regulation is the best in the world for providing free, open and honest markets.

Our interest in internationalization derives from growth and success, not decline and desperation. In February of this year, U.S. mutual fund assets reached an all-time high of $1 trillion. Growth on the part of our foreign counterparts has paralleled our own success. This global success in mutual funds has created a great deal of interest in marketing U.S. mutual funds and investment advisory services abroad.

If permitted to enter foreign markets, we anticipate that our industry and our domestic capital markets will do very well, indeed.

SEC Chairman Richard Breeden recently cited the excellence of the U.S. money management industry and suggested that mutual funds be an American product to be targeted for export. As he put it, "We have the best products in the world." And I'd like to interpolate, Mr. Chairman, that we do not exist in an industry where there is any argument at all about the superiority of American investment money management. There is a big market interested in receiving the services of American investment money managers overseas.

Nevertheless, the success of our industry abroad will depend in large measure on the availability of equal competitive opportunity, which does not exist today.

As we understand it, the intent of S. 2028 would be to authorize the SEC to deny registration as an investment advisor to a person from a foreign country that, according to a finding by the Treasury Department, fails to offer effective market access to U.S. advisors.

We believe the U.S. Government should possess the appropriate tools to negotiate and obtain fair access to foreign markets for U.S. advisors and mutual funds.

Experience shows that U.S. securities firms are not always granted equal access to foreign financial markets. Moreover, foreign firms which develop and grow in the sheltered environment of a restricted market may thereby gain a significant boost to entry into the U.S. market.

Under current law, a foreign investment advisor is unconditionally granted national treatment in the U.S. Access to the U.S. investment advisory and mutual fund markets is in no way denied foreign nationals willing to comply with U.S. securities laws.

By contrast, the experience of U.S. investment advisors in Japan illustrates the need for this legislation. The Japanese investment trust management market historically has been a closed one. Statutory criteria governing the issuance of investment trust management licenses gives the Japanese Ministry of Finance complete control over access to the market. Their subjective, discretionary nature effectively precludes fair market access and only 14 licenses have ever been granted to run mutual funds in Japan. Not one is held by a foreign concern.

In an apparent effort to open the investment trust management market to increase competition, the Japanese Ministry of Finance last December released guidelines describing new standards and procedures for licensing new entrants. However, it is unlikely that the new guidelines will open this market to any significant degree for a number of reasons.

First, the new guidelines reinforce the discretionary authority of the Ministry of Finance. In other words, we will continue to need the equivalent of a certificate of convenience and necessity to do business in Japan.

Second, the guidelines impose significant burdens with respect to distribution and sales arrangements that are particularly onerous for foreign firms.

Third, other requirements of the new guidelines include a form of "local content" regulation with regard to the hiring of Japanese, the requirement that processing work, et cetera, be done in Japan, therefore, increasing costs tremendously.

Thus, Japan will remain a closed shop, with no movement toward a free market on the horizon for financial services. Japanese law and the structure of the Japanese investment advisory industry operate as barriers to potential foreign competition for non-investment trust clients.

Recognizing the trend toward internationalization, the Institute, since 1987, has been engaged in discussions with representatives of the mutual fund industry in the European Community in an effort to open our respective mutual fund markets. Overall, we are optimistic about the prospects for entering into a reciprocal agreement with the European Community.

Any reciprocity agreement would be designed to provide an adequate level of investor protection to investors in both the United States and the European Community. However, whether such agreement will also provide equal market access will be demonstrated only by actual experience.

Thus, the additional authority that would be provided the U.S. Government under S. 2028 is reassuring.

I would like to thank the members of the committee for the opportunity to testify in support of S. 2028, and I would be glad to respond to any questions you might have.

Thank you.

The CHAIRMAN. Thank you very much. Mr. Kim, we'd like to hear from you now, please.

[The complete prepared statement of David Silver follows:]

SUMMARY OF PRINCIPAL POINTS

STATEMENT OF DAVID SILVER

PRESIDENT

INVESTMENT COMPANY INSTITUTE

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

ON S. 2028

"FAIR TRADE IN FINANCIAL SERVICES ACT OF 1990"

APRIL 5, 1990

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I. Introduction

My name is David Silver. I am president of the Investment Company Institute, the national association of the American investment company industry.*/

I am pleased to be here today to express the Institute's support for S. 2028, the "Fair Trade in Financial Services Act." We in the mutual fund industry concur in Chairman Riegle's belief that "[n]o issue is more important . . . than the competitiveness of all sectors of our economy in today's global environment." As the world's financial markets become increasingly linked, it becomes more and more important that we be sensitive to and capable of redressing competitive inequities that can arise in a global marketplace. S. 2028 represents a major step toward equipping our government with the means needed to obtain competitive access for U.S. securities firms in the international financial markets. It is a significant advance toward a truly open marketplace.

The Institute's specific concern with issues of foreign market access and international competitiveness arise in three distinct areas: 1) U.S. investment advisers seeking to advise and manage mutual funds organized abroad; 2) U.S. advisers seeking to provide investment advice abroad to non-mutual fund clients; and 3) U.S. mutual funds seeking to sell their shares abroad. In each of these instances market access is essential. If U.S. advisers and mutual funds are to compete in these three areas, our government must have a wide range of negotiating tools, including the ability to withhold access to the U.S. markets unless equality of competitive opportunity is provided in

*/ The Institute's members include 3,004 open-end investment companies, commonly known as mutual funds, 192 closed-end investment companies and 13 sponsors of unit investment trusts. The mutual fund members of the Institute currently hold assets of about $949 billion on behalf of over 30 million shareholders. The Institute's members also include investment advisers, many of whom render investment advice to both investment companies and other clients. An additional 546 associate members of the Institute render investment advisory services exclusively to non-investment company clients. A substantial portion of the total assets managed by registered investment advisers are managed by these Institute members and associate members.

foreign markets. For that reason, the Institute supports the objectives of S. 2028.

II. The Globalization of the Financial Services Markets

Globalization of the securities markets has sparked a great deal of interest in marketing mutual funds and investment advisory services abroad. Technological changes permitting 24 hour worldwide securities trading, a growing middle class with the concomitant demand for broader investment opportunities and unprecedented consumer acceptance of mutual funds have created a strong potential for exporting U.S. mutual funds and investment advisory services.

A. Mutual funds have experienced a decade of expansion and prospects look favorable for future worldwide growth.

The U.S. mutual fund industry has experienced phenomenal growth over the past several years. In January of this year, U.S. mutual fund assets reached an all-time high of $1.007 trillion, more than ten times the level of such assets ten years ago. This tremendous growth in mutual fund assets has not been confined to the U.S. In fact, mutual fund assets grew dramatically worldwide. For example, since 1983, the growth of mutual funds in Japan has been 600 percent, in Italy 2,000 percent, in Germany 330 percent and in the United Kingdom 350 percent. The mutual fund markets of other countries including Australia, Canada, India, Mexico and many South American countries also have grown at remarkable rates. Such increases clearly illustrate a wide recognition of the benefits of mutual fund investing as well as the growing ability of hundreds of millions of people to accumulate discretionary assets.

In the U.S. and elsewhere, favorable economic conditions have clearly contributed to this growth, as have the industry's efforts to broaden its selection of investment alternatives to appeal to wider markets. In addition, the inherent advantages of pooled, managed investments are increasingly being recognized by both individuals and institutions in a financial world of growing complexity.

There are numerous indications that the world-wide market potential is substantial. For example, mutual fund assets, impressive as they are, currently comprise a relatively small percentage of total financial assets in the international marketplace. In addition, the sheer size of the market, including an estimated 320 million in the EC countries alone, also suggests that tremendous opportunities remain. So too do recently published statistics on savings levels for the average Japanese family--$86,250 as of 1989.

B. The U.S. money management industry should be exported abroad.

The growth of the U.S. money management industry should be enhanced rather than hindered by the increasing globalization of the financial markets. Securities and Exchange Commission Chairman Richard Breeden has specifically cited the excellence of the U.S. money management industry and has targeted mutual funds as an American product that should be exported, noting that "[w]e have the best products in the world in that area." Despite the well-documented high quality of our industry's products and services and the attractive growth potential in overseas markets, however, the continued growth of our industry abroad will depend in large measure on the availability of equal competitive opportunity, as would be more likely if S. 2028 were enacted.

III. The Institute Believes that S. 2028 is Both Necessary and Appropriate.

We understand that the intent of S. 2028 is, among other things, to authorize the Securities and Exchange Commission to deny registration as an investment adviser to a person from a foreign country that, according to a finding by the Treasury Department, discriminates against American investment advisers by failing to offer the same competitive opportunities, including effective market access, as are available to domestic investment advisers.

Thus, the bill would, in effect, permit the U.S. government to pre-condition the grant of national treatment to a foreign adviser on the grant by that adviser's home country of equitable market access to U.S. advisers. If a particular foreign country restricted either directly or indirectly the market access of U.S. investment advisers seeking to operate in that country, the U.S. government would be authorized to restrict the market access of advisers from that country.

We believe that the increasing globalization of the securities markets will intensify competition across national borders. While we welcome the challenge of increased competition from abroad, a level playing field for all competitors is essential. We, therefore, believe that the U.S. government should be empowered with the appropriate tools to negotiate for and obtain equal access to the financial markets for U.S. advisers and mutual funds. Our government should not be obligated to follow a supine policy of granting unconditional national treatment and market access to foreign financial institutions without regard to the treatment of U.S. institutions in the home country of such foreign institutions.

Unconditional national treatment and foreign access to the U.S. financial markets may competitively disadvantage American

financial institutions in at least two ways. First, we have learned through experience that U.S. securities firms are not always granted equal access to foreign financial markets despite the availability of national treatment to foreign financial firms seeking access to the U.S. markets.

Second, there seems little doubt that foreign firms which develop and grow in the sheltered environment of a restricted market may benefit from the existence of a monopoly or oligopoly in their home country. The profits gleaned from growth in this protected environment may provide a significant boost to entry into another market, such as the U.S.

IV. Although Foreign Advisers Receive National Treatment in the U.S., American Advisers Are Not Always Granted Equitable Market Access Abroad.

Under current law, a foreign investment adviser is unconditionally granted national treatment in the U.S. Upon registration, such an adviser could provide investment advisory services to the entire range of clients also available to U.S. advisers. In addition, such an adviser can sponsor and advise a domestic mutual fund to be marketed to U.S. investors by registering that fund with the SEC in compliance with the Investment Company Act of 1940 and other applicable securities laws. Thus, access to the U.S. investment advisory and mutual fund markets is in no way denied to foreign nationals willing to comply with U.S. securities laws, which, while complex, are even-handed in their application and are generally pro-competitive in their policies. Therefore, all are free to compete on a level playing field with U.S. advisers and mutual funds.

By contrast, the experience of U.S. investment advisers in Japan illustrates the need for legislation such as S. 2028. Although as a technical matter American and other non-Japanese investment advisers are granted national treatment with respect to the management of Japanese investment trusts (the analogue of U.S. mutual funds) the practical reality in Japan illustrates a wide gulf between national treatment and equality of market access. Moreover, non-Japanese advisers are not granted even ostensible national treatment with respect to all other advisory activities.

A. The licensing of managers of Japanese investment trusts (mutual funds) falls entirely within the discretionary authority of the Japanese Ministry of Finance.

The Japanese investment trust management market historically has been a closed one. Overlaid on otherwise familiar securities law requirements is a discretionary licensing procedure. To date, the Japanese Ministry of Finance has granted investment trust management licenses to only 14 firms, all of which are

Japanese. Only one of these licenses has been granted in the last two decades.

The closed nature of this market is not surprising, considering the criteria for obtaining an investment trust management license in Japan. These criteria, which are prescribed by Article 7 of the Japanese Securities Investment Trust Law, give the Japanese Ministry of Finance complete control over applicants' access to the market. While the three statutory criteria apply equally to Japanese and non-Japanese applicants, thereby suggesting a policy of national treatment, a closer look reveals that the subjective, discretionary nature of these standards effectively precludes fair market access.

Specifically, Article 7 prescribes three conditions which must, in the judgment of the Japanese Ministry of Finance, be satisfied before a license may be granted to manage investment trusts in Japan. First, the applicant must be "sufficiently qualified" to engage in management of an investment trust. This criterion requires an evaluation of the applicant's personnel structure, experience in and ability to invest in securities. Second, an applicant's business prospects as a management company must be "sufficiently bright." The third criterion is not related to the applicant's qualifications, but rather requires a finding that the applicant's business as a management company is "necessary and appropriate in the light of the existing condition of the securities investment trust business and the securities market." All three criteria are subjective, and the third criterion is also entirely beyond the control of the applicant.

As early as 1987, the Institute engaged in informal discussions with the Japanese regarding the criteria for obtaining a license to manage domestic Japanese investment trusts. In addition, Japanese and U.S. trade groups have continued friendly contacts which had been established some years previously at the initiative of the Investment Trust Association, the leading mutual fund association in Japan. Thus, we and others were hopeful when we learned that the Ministry of Finance asked that a white paper examining possible revisions to the Japanese law regarding investment trusts be prepared. We were pleased that the white paper, published last year, concluded that new entrants into the industry would "further induce competition and contribute to an improvement of management records and an increase in investors' profits through new product development". However, the white paper did not recommend any basic change in the restrictive licensing procedure.

Following the issuance of the white paper, the Japanese Ministry of Finance last December released guidelines describing the standards and procedures for licensing new entrants into the Japanese investment trust management business. Based on my own experience in discussing these matters with our Japanese

colleagues, I believe the guidelines represent, from a Japanese perspective, a sincere effort to open the Japanese investment trust management market to increased competition. However, it is unlikely that the new guidelines will do so to any significant degree for several reasons.

First, because the new guidelines continue the discretionary authority of the Ministry of Finance to determine whether conditions warrant granting a new license, no semblance of a free market is created. No license will be granted under the new guidelines unless it is found that "the business that the company is to carry out [is] necessary and appropriate in light of existing conditions in the securities investment trust and the securities market."

Second, in addition to reiterating the discretionary authority of the Ministry of Finance, the guidelines impose significant burdens on license applicants that are particularly onerous for foreign firms. For example, among the requirements for an investment management company applying for a license is the advance existence of firm sales arrangements. Establishing a sales network before even applying for a license involves its own set of obstacles: direct sales to the Japanese public are not permitted, and the four major Japanese securities firms dominate the distribution segment of the market. One possible way to gain entry is through a joint venture with a Japanese broker-dealer, but this option hardly offers a satisfactory solution in view of the existing business arrangements which channel these firms' sales efforts in the direction of investment trusts organized by Japanese firms.

Third, other requirements listed in the new investment trust management licensing guidelines include a form of "local content" regulation. Thus, a newly registered manager would have to maintain sufficient personnel in Japan "to properly perform the investment trust business." This standard apparently translates to about 30 people. The guidelines also require the establishment of a separate subsidiary with a minimum capitalization of 500 million yen (or approximately $3.2 million). These requirements together preclude those firms with existing fund management staffs and offices in Japan from using those resources in connection with their investment trust business. They are expected to make operating costs three or four times higher than necessary. The new guidelines also prohibit a management company from contracting with a specialist third party to perform transfer agency services or other back office functions, a common practice in the United States, and place limits on a company's ability to raise capital from Japanese minority shareholders.

In sum, the Japanese investment trust management licensing guidelines require a substantial and unnecessary, up-front commitment of both financial and personnel resources which ultimately may be for naught if, in the discretion of the Ministry of Finance, an additional investment trust management company is not "necessary and appropriate" in light of existing market conditions.

According to Japanese newspaper reports, the Ministry of Finance plans to license some foreign firms later this year. As of the February 28 deadline for applications, however, only four foreign firms, one of which is American, were still in the running. This could be an indication that no one else is willing to make the major commitment of time, personnel and money that would be required. Therefore, as regards mutual funds, Japan remains a "closed shop"--with no movement toward a free market on the horizon.

B. Foreign advisers are granted neither national treatment nor effective market access to other investment advisory clients in Japan.

Japanese law and the structure of the Japanese investment advisory market also operate as barriers to potential foreign competition for non-investment trust clients. Under Japan's 1986 Investment Advisory Law there are two levels of registration. Under the first level, a registered investment adviser is authorized to give advice as to the value of securities and to make recommendations regarding investment decisions, but cannot engage in discretionary management. Under the second level, a registered discretionary manager, who must first obtain an investment adviser's license, is authorized to make investments on behalf of a client, but not to manage pension plans or investment trusts. The assets of those entities, which of course constitute an enormous portion of the market, traditionally have been managed by Japanese insurance companies and trust companies.

It is our understanding that legislation allowing registered discretionary managers to manage certain corporate pension plan assets was recently adopted and becomes effective this month. However, it appears that this change creates little, if any, new opportunity for American investment advisers. The new legislation limits the pension plan assets available to a discretionary manager to plan contributions made after the adviser's application is approved by the appropriate regulatory authorities. Moreover, a prospective pension plan adviser must have a potential client before applying.

V. Effective Market Access is Essential for Marketing U.S. Mutual Funds Abroad.

Experience has shown that, in the case of mutual funds seeking to market their shares abroad, effective market access is essential. For example, in Germany U.S. firms have enjoyed excellent cooperation from regulatory authorities enabling U.S. funds to satisfy German registration requirements. Nevertheless, the structure of distribution channels in Germany acts as a barrier to U.S. funds. Moreover, segments of the German banking community successfully opposed the inclusion of money market funds in the EC mutual funds directive discussed below. In France and the United Kingdom, even the registration of U.S. funds is practically impossible. In these countries, legal impediments deny U.S. funds effective market access.

Recognizing the trend toward internationalization of the mutual fund industry, the problems of European market access and the significance of "Europe 1992", the Institute, since 1987, has been engaged in discussions with representatives of the mutual fund industry in the European Community in an effort to reach an agreement opening these mutual fund markets.

A possible U.S.-EC agreement would logically be modeled on the European Community directive, effective October 1, 1989, relating to "undertakings for collective investment in transferable securities." This directive, commonly referred to as the UCITS directive, represents a significant milestone for the internationalization of mutual fund markets. UCITS is designed to harmonize the various laws and regulations of the EC member countries governing collective investment pools (European analogues for U.S. mutual funds) by prescribing a common level of investor protection. The theory behind the UCITS directive is that funds meeting the directive's criteria and authorized under their home state law will be permitted to market their shares in the other member states. Funds cross-marketed under the UCITS directive generally are subject to home country regulation, although each EC host country may require compliance with its own non-discriminatory marketing rules. Any such reciprocity agreement would be designed to provide an adequate level of investor protection to investors in both the U.S. and the EC.

Overall, we are optimistic about the prospects for entering into a reciprocal sales agreement with the EC countries based on a common level of investor protection. We have also received encouragement from the SEC and the Treasury, which will, along with their EC counterparts, have the final responsibility to recommend appropriate legislative action implementing the agreement.

Whether any such agreement will, in effect, provide equal market access will be demonstrated only by actual experience.

For example, I expect that any U.S.-EC reciprocity agreement, like the UCITS directive itself, would leave local marketing rules in place. Although the UCITS directive requires that such marketing rules not discriminate against foreigners, the impact of such local marketing rules is unclear.

We are hopeful that a U.S.-EC reciprocity agreement would provide the basic framework for equality of competitive opportunity. If, however, an EC agreement proves elusive, it may well be productive to engage in reciprocity discussions with specific European countries, such as the UK, where we believe both the industry and the regulatory authorities would be receptive. In either event, the additional authority that would be provided the U.S. government under S. 2028 is reassuring.

Even if an agreement with the Europeans on securities law issues becomes possible, it has become very apparent that U.S. funds will not be able to compete in the European market in a meaningful way unless relief from certain domestic tax law provisions is forthcoming. Existing U.S. tax laws create major disincentives for most potential foreign investors. We believe these tax consequences are unintended barriers and arise primarily from domestic principles of taxation which are increasingly inapposite on the international scene. By failing to remove the existing tax disincentives for foreign investors in U.S. mutual funds, we create a one way street favoring foreign funds over U.S. funds.

Changes to domestic tax law would permit U.S. mutual funds to compete for foreign investment dollars. By eliminating the tax disincentives for foreign investment in U.S. mutual funds, we can increase capital formation in the U.S. in a way that does not result in foreign control of U.S. businesses.

In the context of any proposed agreement to open mutual fund markets, I should also note that we view S. 2028 as a complement to the current standard in section 7(d) of the Investment Company Act of 1940. That provision permits a foreign firm to create and market a domestic mutual fund in the U.S. in accordance with applicable securities laws. However, it does not permit a foreign fund to be marketed in the U.S. unless such fund meets investor protection standards essentially identical to those applicable to U.S. funds. We realize that a lowering or relaxation of the standard of section 7(d) may be urged from time to time by foreign governments. We are, therefore, comforted that S. 2028 is designed to enhance the leverage of the U.S. government in its effort to achieve equal access without sacrificing our existing regime of investor protection. We trust that any pressure to further enhance the competitive advantages enjoyed by foreign interests would be resisted by this Committee and the Congress.

VI. Conclusion

The mutual fund industry throughout the world has experienced explosive growth in recent years. Increasing globalization of the world's financial markets, coupled with ample evidence of significant remaining growth potential in the mutual fund and investment advisory markets, make true international competition in those areas an attractive goal. Despite tremendous success domestically, however, U.S. mutual funds and investment advisers to date have faced a multitude of barriers to effective entry into foreign markets. The experience of U.S. investment advisers and mutual funds which have attempted to export abroad contrasts sharply with the treatment of foreign advisers wishing to enter the U.S. market. We believe that S. 2028 will provide our government with the means to achieve the goal of opening global mutual fund and investment advisory markets to effective and equitable international competition. We, therefore, applaud the Committee's efforts in this regard and support the enactment of S. 2028.

* * * * *

On behalf of the Investment Company Institute, I would like to thank the members of this Committee once again for the opportunity to testify in support of S. 2028. I would be glad to respond to any questions you might have.

STATEMENT OF CHARLES KIM, PRESIDENT, CALIFORNIA CENTER BANK, LOS ANGELES, CA, REPRESENTING THE INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. KIM. Mr. Chairman and members of the committee, my name is Charles Kim. I am president and chief executive officer of California Center Bank in Los Angeles, CA.

I am appearing this morning on behalf of the Independent Bankers Association of America, [IBAA].

The IBAA is the only national trade association that exclusively represents the interests of our nation's community banks.

I appreciate the opportunity to testify this morning on S. 2028, the Fair Trade in Financial Services Act, which IBAA endorses as consistent with both its membership's philosophy and with existing national and international policy.

This bill will provide our regulators with an important tool in seeking effective market access for U.S. banks and securities firms.

S. 2028 will refine the policy of the United States, which, since 1978, has been one of unconditional national treatment. Foreign banks operating in the United States have been treated the same as domestic banks, without regard to the home country's policy toward U.S. banks' participation in their markets.

And why, you may consider, are community banks concerned with this issue?

At our recent annual convention in San Francisco, the IBAA membership adopted a resolution stating, in part, that:

> We believe that the home country of the foreign acquiror should provide national treatment to U.S. banks seeking to establish or currently operating banking institutions in that country.

We support this bill because it provides an element of fairness in attempting to secure for American financial interests the same treatment accorded to foreign firms doing business in the United States. Opening foreign markets may also address part of the reason for the extensive presence of foreign banks in the United States.

Some of these countries operate in a protected home market, subsidizing their activities and ability to increase their U.S. market share. It is well known that more than 260 foreign banks now control 25 percent of U.S. bank assets. This market penetration is not only in the major market areas, but also in small pockets across the nation where community banks prosper.

Today, I would like to illustrate the experience of the California Center Bank, which markets to the Korean-American community, as an example of a community bank which may have an interest in expanding overseas, and which is adversely affected by foreign bank competition in the United States.

United States community banks of foreign immigrants, like ours, may be interested in seeking entry as a U.S. bank into their home country's financial market. We would obviously wish to be accorded effective access to the foreign country's market—Korea, in our case.

As the world's economy is becoming integrated at an accelerated pace, community banks in the future are more likely to enter into international banking operations. This may be particularly so with

foreign immigrant community banks, evolving in the 1990's as what I would like to call "international arena community banks," which have far less resources than major banks, but stronger ties to and a better understanding of the culture of the country whose market it seeks to do business in.

As the consumer banking market takes on greater emphasis than before in overseas banking activities, U.S. community banks of foreign heritage may be inherently better equipped to handle that sector of the market than major banks.

And although there has been significant regulatory improvement for foreign bank operations in Korea as a result of bilateral trade talks, restrictive measures against foreign banks still exist.

For example, the Korean Government has reduced foreign bank access to foreign currency swap facilities. Along with preventing a rapid expansion of branch outlets, this has limited the access of foreign banks in Korea to local currency deposits.

While entry for my bank into the Korean market is an issue to be resolved in the future, the presence of Korean banks in the U.S. market is a matter which has current consequences.

A predominant bank in the Korean-American community banking market in the United States is a wholly-owned subsidiary of a conglomerate Korean bank. It controls more than 42 percent of the Korean-American community banking market in the greater Los Angeles area. It has been accorded unconditional national treatment and operates under the same laws and regulations of the locally-owned community banks of Korean-American immigrants.

But it has several distinct advantages over its community bank counterparts.

It has the image of a "too bit to fail" bank with local Koreans because of the towering status of its parent bank in Korea.

It has access to unlimited capital from the parent company.

It has institutional connections to the parent bank's extensive branch network.

And unlike other potential American competitors, it understands the ethnic culture and language on a level with the community banks.

This competition puts considerable pressure on the smaller ethnic community banks of Los Angeles, particularly for those struggling through their most difficult periods of infancy.

I discussed an example of where the ability of U.S. banks to compete effectively in a foreign country is limited. I am sure you have examples of cases even more egregious than that of Korea, which has recently made substantial progress in opening the financial sector of its domestic market to foreign interests.

In conclusion, passage of this bill is certain to notify foreign officials that our negotiators will be dealing from a position of strength which was not previously available.

IBAA urges the committee to adopt S. 2028.

Thank you again for the opportunity to address this important issue.

Mr. SILVER. Mr. Hayden, you would be next.

[The complete prepared statement of Mr. Kim follows:]

Testimony of

INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Charles C. Kim
President and CEO, California Center Bank
Los Angeles, California

before the

Senate Committee on Banking, Housing and Urban Affairs

Hearing on S. 2028,
the "Fair Trade in Financial Services Act of 1990"

Thursday, April 5, 1990

Summary of Testimony of Charles C. Kim
Independent Bankers Association of America

IBAA supports the goal of S. 2028 in seeking to provide American firms abroad "equality of opportunity to compete in actual practice," rather than just according to the letter of the law. We agree that our current policy of "unconditional national treatment" should be replaced by one that seeks fairness for American firms in foreign markets.

At our recent annual convention, the IBAA membership recognized the importance of this issue by adopting a resolution stating, in part, that "IBAA is deeply concerned about the growing number of U.S. banks controlled by foreign interests and the increasing control of U.S. financial resources by foreign interests...we believe that the home country of the foreign acquiror should provide national treatment to U.S. banks seeking to establish or currently operating banking institutions in that country."

S. 2028 provides an element of fairness in attempting to secure for American financial interests the same treatment accorded to foreign firms doing business in the U.S. Opening foreign markets may also address part of the reason for the extensive presence of foreign banks in the U.S. Some of these countries operate in a protected home market, subsidizing and underwriting their activities and ability to increase their U.S. market share, and perhaps allowing them to conduct predator acquisitions. It is well known that more than 260 foreign banks now control 25 percent of U.S. bank assets. This market penetration is not only in the major market areas, but also in small pockets across the nation where community banks prosper.

The experience of the California Center Bank, a Korean-American community bank, is an example of a community bank that could benefit from the new policy advocated in this bill. While California Center Bank may wish to open a branch in Korea in the future, potential obstacles formed by the Korean government currently stand in the way. Foreign bank penetration into the Korean market has been restricted by a variety of government policies. In the meantime, Korean-immigrant community banks in the U.S. have been struggling to compete with a wholly-owned subsidiary of a Korean conglomerate.

By enacting S. 2028, our government will have the leverage to address these inequitable competitive situations. American banks deserve the opportunity to have fair access to foreign markets, and should not have to compete against subsidized foreign bank activity at home.

Mr. Chairman and members of the committee, my name is Charles Kim. I am President and Chief Executive Officer of California Center Bank in Los Angeles, California and am appearing this morning on behalf of the Independent Bankers Association of America (IBAA). The IBAA is the only national trade association that exclusively represents the interests of our nation's community banks.

I appreciate the opportunity to testify this morning on S. 2028, the "Fair Trade in Financial Services Act," which IBAA endorses as consistent with both its membership's philosophy and with existing national and international policy. This bill will provide our regulators with an effective tool in further implementing our national policy of seeking national treatment for U.S. banks and securities firms. By amending section 3602 of the Omnibus Trade and Competitiveness Act of 1988, and other relevant statutes, S. 2028 will specify that national treatment includes "effective market access." We support the goal of this bill in seeking to provide American firms abroad "equality of opportunity to compete in actual practice," rather than just according to the letter of the law. The policy of the U.S. since 1978 has been one of "unconditional national treatment." Foreign banks operating in the U.S. have been treated the same as domestic banks, without regard to the home country's policy toward U.S. banks' participation in their markets. "In this regard," according to Treasury Undersecretary David Mulford in recent testimony before the House Banking Committee Task Force on International Competitiveness, "we are increasingly in a minority in the international community."

S. 2028 also appears to make our policy on national treatment consistent with that of the European Community under section 9 of the Second Banking Directive, to be implemented on January 1, 1993. According to BNA's Banking Report of March 26, the EC policy was restated by Sir Leon Brittan, the European Community Vice Chairman for Competition and Financial Institutions, also meeting with the Task Force on International Competitiveness. Brittan reportedly said that the "EC will consider whether the foreign company's country discriminates against foreign banks, by treating them differently than they treat their domestic banks, and whether the foreign country provides effective market access to non-domestic firms...If a 'country' does discriminate against an EC member entity, the EC will withhold licenses for that country's firms to operate throughout the Community." The bill under consideration today actually appears to provide more flexibility than the EC policy. It would direct the Treasury to negotiate to obtain effective treatment; should that fail, only then would the regulators be authorized, in their discretion, to deny applications to foreign firms wishing to expand their activities in the U.S. We agree that the flexibility offered by this approach could help open new markets for American banks and securities firms.

And why, you may consider, are community banks concerned with this issue? At our recent annual convention, the IBAA membership adopted a resolution stating, in part, that "IBAA is deeply concerned about the growing number of U.S. banks controlled by foreign

interests and the increasing control of U.S. financial resources by foreign interests...we believe that the home country of the foreign acquiror should provide national treatment to U.S. banks seeking to establish or currently operating banking institutions in that country."

Our bankers, therefore, have recognized this as an issue with important consequences for our national economy. We support this bill because it provides an element of fairness in attempting to secure for American financial interests the same treatment accorded to foreign firms doing business in the U.S. Opening foreign markets may also address part of the reason for the extensive presence of foreign banks in the U.S. Some of these countries operate in a protected home market, subsidizing their activities and ability to increase their U. S. market share, and perhaps allowing them to conduct predator acquisitions. It is well known that more than 260 foreign banks now control 25 percent of U.S. bank assets. This market penetration is not only in the major market areas, but also in small pockets across the nation where community banks prosper.

Today, I would like to illustrate the experience of the California Center Bank, a community bank marketing to the Korean-American community, as an example of a community bank which may have an interest in expanding overseas, and which is definitely adversely affected by foreign bank competition in the U.S.

U.S. community banks of foreign immigrants, like ours, may be interested in seeking entry as a U.S. bank into their home country's financial market by opening a branch. We would obviously wish to be accorded effective access to the foreign country's market--Korea, in our case. As the world's economy is becoming integrated at an accelerated pace between the East and West and the North and South, community banks in the future are more likely to enter into international banking operations. This may be particularly so with foreign immigrant community banks, evolving in the 1990s as, what I would like to call, "international arena community banks," which have far less resources than major banks, but stronger ties to and a better understanding of the culture of the country whose market it seeks to do business in. This "international arena community bank" may be much more effective than a major conglomerate bank in penetrating into certain pockets of the local market in that country because of its greater ties to its culture and heritage.

During the coming decade, international banking may become an area no longer exclusively reserved for major banks to conduct corporate banking, but also for community banks of foreign connection to conduct consumer and middle market banking. As the consumer banking market takes on greater emphasis than before in overseas banking activities, U.S. community banks of foreign heritage may be inherently better equipped to handle that sector of the market than major banks.

While there has been significant regulatory improvement for foreign bank operations in Korea as a result of bilateral trade talks

which appear to be ongoing, restrictive measures against foreign banks still exist. For example, the Korean government, after accumulating substantial foreign exchange reserves, has reduced foreign bank access to foreign currency swap facilities. Along with preventing a rapid expansion of branch outlets and not allowing the sale of certificates of deposit below a certain level, this has limited the access of foreign banks in Korea to other market-oriented sources of local currency deposits.

This can be demonstrated with a glance at a few statistics on the penetration of foreign banks into the Korean market. There are currently 66 foreign banks operating in Korea, 19 of which are American. At year-end 1989, the total assets of foreign banks accounted for 9.6% of the Korean market, 2.2% of which were in U.S. banks. Their share of total deposits, however, was at a much lower .73%. In fact, foreign banks' share of the deposit market has been falling off since 1986, from a high of 1.47% that year to its current rate. Foreign banks' share of the loan market also fell by .89% from 1988 to a level of 4.54% last year.

While entry for my bank into the Korean market is an issue to be resolved in the future, the presence of Korean banks in the U.S. market is a matter which has current consequences. California Korea Bank in Los Angeles is a wholly-owned subsidiary of the Korea Exchange Bank. It controls more than 42% of the Korean-American community banking market in the greater Los Angeles area. It has been accorded unconditional national treatment and operates under the same laws and regulations of the locally owned community banks of Korean-American immigrants. But California Korea Bank has several distinct advantages over its community bank counterparts: (1) it has the image of a "too big to fail" bank with local Koreans because of the towering status of its parent bank in Korea; (2) it has access to unlimited capital from the parent company to handle the local ethnic banking market; (3) it has institutional connections to the parent bank's extensive branch network to serve the local Korean consumer and business market; and (4) unlike other potential American bank competitors, it understands the ethnic culture and language on a level with the community banks. In addition, it has imported a well-trained banking bureaucracy and know-how from the home country.

Because of its stronger capital position and access to low-cost capital, California Korea Bank can afford a strategy of extensive branch network development in the local market for the purpose of establishing a dominant market share, rather than adding to profit.

This competition between David and Goliath puts considerable pressure on the smaller ethnic community banks of Los Angeles, particularly for those struggling through their most difficult periods of infancy.

I discussed an example of where the ability of U.S. banks to compete effectively in a foreign country is limited. I am sure you have examples of cases even more egregious than that of Korea, which has made some progress in opening the financial sector of its domestic market to foreign interests.

In conclusion, I am sure that the introduction of S. 2028 is in itself a signal to foreign governments that the United States is serious about doing all it can to assure that its financial services industry is treated fairly -- both abroad and at home. Passage of this bill is certain to notify foreign officials that our negotiators will be dealing from a position of strength not previously available. To help the competitive position of banks like mine and other banks domestically, or to assist those banks wishing to compete abroad, the IBAA urges the Committee to adopt S. 2028.

Thank you again for the opportunity to address this important issue. I will be happy to answer any questions you may wish to ask.

STATEMENT OF ERIC W. HAYDEN, PRESIDENT, INVESTORS BANK & TRUST CO., BOSTON, MA

Mr. HAYDEN. Thank you, Mr. Chairman. And thank you for the opportunity to appear before your committee.

I have been asked specifically to address the subject of Japan. I have been in banking for 15 years, half of which was spent in Japan with, what was then, the largest bank in the world, Bank of America.

My activity involved, among many other things, working with the foreign banking community and the Japanese, to achieve interest rate deregulation and financial markets liberalization. I will share with you shortly some of my observations derived from those 7½ years working in Japan.

At the outset, let me assure you that I fully endorse this bill that you have before you and the concept of reciprocal national treatment. Like most Americans, I am concerned with the erosion of American financial global pre-eminence. When I left Japan 5 years ago, foreign banks had a 3 percent market share. Today, we have about half of that.

Meanwhile, Japanese banks here have grown their share of our domestic banking assets from 5 percent a decade ago to some 15 percent today.

Another reason I endorse your bill, Mr. Chairman, is the greater powers it provides Treasury negotiators. The lack of these powers has considerably limited the extent to which we have realized reciprocal national treatment. One of the great frustrations to expatriate American bankers in Japan was that, as we were urging the Japanese to liberalize their financial system, we realized fully that our government lacked any meaningful powers to help us achieve the liberalizations that we so desperately sought.

Indeed, in many ways, it is unfortunate that S. 2028 comes now. It would have been wonderful to have had it in 1978 at the time we were starting to push the Japanse for the changes we wanted in their financial system.

You will be aware at the several liberalizations that have occurred in the financial arena in Japan. People more qualified than I have already addressed those today and in other fora. You will be equally aware, however, that Japan is far from being the open financial system that one would hope and certainly expect of a country of its size. Perhaps most discouraging, however, is the lack of transparency in the process of developing and implementing national policies, official regulations, and administrative guidance. Clearly written policies in Japan are the exception rather than the rule. Financial bureaucrats exercise monumental powers to interpret laws as they see fit. And they are not above intimidation.

I am quite concerned and personally troubled by the lack of willingness of the major security houses and the major banks in this country to appear before this committee to endorse this legislation. There are reasons for this reluctance.

Our investment banks have, though a series of measures that were previously referred to, attained membership on Tokyo stock exchange, they now benefit from the fixed brokerage commissions in Japan, and they are members of the government bond syndicate.

They have told me personally that they are reluctant to appear before this committee, because they are reluctant to upset the Japanese. Indeed, they are now cozy insiders benefiting from a restricted financial environment.

The major commercial banks are also fearful about appearing here because they recall vividly the negative results of our efforts some 10 years ago to achieve interest deregulation and negotiable certificates of deposit. While we won that battle and got negotiable CD's, the Ministry of Finance took away our exclusive access to the one product that we made any money on, namely foreign currency loans. This unique niche that we had been granted in 1945 was suddenly taken away from us in 1979. Within 2 years, we had gone from 100 percent market share to some 5 percent, all because we foreign bankers had been arguing for significant market change in Japan.

Today, in Tokyo——

Senator GARN. Mr. Hayden?

Mr. HAYDEN. Yes, sir.

Senator GARN. If I could interrupt you. I think that's so important. Let me read your paragraph so that nobody misses it.

In speaking with representatives of major American banks and investment firms about their reluctance to testify at this hearing, I was once again reminded of the inordinate power of the Japanese financial authorities. Foreign securities houses, having recently gained some access to Government bond syndicate, the fixed commission structure of the local brokerage industry, and membership on the Tokyo Stock Exchange, have on more than one occasion expressed their reluctance to press for further openings, lest they risk what little they have managed to gain after years of advocacy.

In the case of the present hearings, they've decided to let well enough alone. Having recently been allowed to participate in the cartel-like arrangement of fixed commissions, they apparently savor being on the inside after years of being outsiders.

It's rare that I give the witness his testimony, but as you state it, I want to make sure nobody missed that paragraph because that's very important that we're not getting people here who would like to be witnesses because they are afraid they will be penalized if they show up.

Thank you, and excuse me for interrupting you.

Mr. HAYDEN. Not at all, sir.

In Tokyo today, American banks are in the midst of reassessing whether they want to remain in Japan. Their market share has declined, as I have already noted. Despite liberalizations that have occurred, their access to local funds remains limited. They are restricted in branching activities. They face onerous regulatory interventions which severely constrict their ability to perform. And their operating costs have soared to unacceptable levels.

In this environment, we really need to ask if liberalizing the Japanese financial market ought to be the top priority of this country. It certainly should have been years ago. I applaud the committee for focusing on this effort. But I would caution that, while pushing Japan towards a more market-driven financial system would obviously be consistent with American-style capitalism, can we ever really succeed? And if so, can we expect foreign financial institu-

tions to necessarily get a larger share of that country's financial pie?

In short, despite our efforts to force the Japanese financial system open, it remains frustratingly closed. True, we have made some gains. However, the reality is that we have been thrown little more than a few bones over the years. Despite formal changes, the financial system continues to fuel Japanese economic growth by ensuring ample capital formation at bargain-basement prices for Japanese companies.

Financial market liberalization has proved to be no different from Japan's steps to liberalize its retail, agricultural or high technology sectors. We can pound the table and come home with some victories, as we do periodically, but we never seem to win the real fight of obtaining meaningful access the to Japanese market for our financial institutions.

Instead of trying to remake Japan in our own image, perhaps it might be more appropriate to accept the fact that Adam Smith's invisible hand is not extended to Tokyo. What the Japanese judiciously call "administrative guidance" is actually the embodiment of an economic system quite different from our own brand of laissez-faire capitalism.

Fundamentally, theirs is a system in which government bureaucrats play a vital role in keeping the peace by ensuring that the various participants retain their respective niche roles. In the world of finance, that means neatly defined roles separating the banking industry from the brokerage industry, the short-term lenders from the long-term lenders, and the lenders from the trust bankers.

Obviously, the United States can take the powers provided by S. 2028 and demand that, if American financial institutions are not given open access to the Japanese financial system, then Japanese banks or securities houses will be denied application for regulatory approval in this country.

But given the strategic reassessment currently underway at most U.S. commercial banks operating in Japan, do we really want to arm our Treasury officials to fight for the Model T in an era of the turbo jet? Perhaps we are better advised to focus on distinct market niches where we excel, where we can argue, I think effectively, that those are the two or three or four things that we really want, rather than an across-the-boards, complete and total liberalization.

Some of those areas where we excel and where we ought to push for our niche include risk management, trust banking, and leasing. We ought also to argue for the creation of a viable corporate debt securities market in Japan something in which our commercial banks have obtained some experience in the past few years. And as Glass-Steagall erodes and commercial banks in this country expand their abilities to underwrite and distribute debt securities, we have tremendous experience that we can bring to Japan.

Japan also lacks a book-entry system of handling securities. I think that as they move towards a viable debt securities market, they will ineritably need a book-entry system, thereby increasing opportunities for American banks to provide their capability in the area of custody services.

Mr. Chairman, my time is up. Thank you very much for the opportunity to appear before your committee today.

[The complete statement of Eric W. Hayden follows:]

April 5, 1990

TESTIMONY BEFORE THE UNITED STATES SENATE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

Eric W. Hayden
President
Investors Bank & Trust Company
Boston, Massachusetts

SUMMARY

1. I fully endorse the standard of national treatment as the basis for negotiating access to foreign markets. Furthermore, our negotiators have long been at a disadvantage in gaining access for U. S. institutions to foreign financial markets because they lack the power to invoke reciprocity. By amending both the International Banking Act of 1978 as well as the Securities Exchange Act of 1934 to include provisions for national treatment, and by permitting our regulators to deny applications by banking and securities firms from countries discriminating against U. S. firms, the Fair Trade in Financial Services Act of 1990 (S.2028) takes an important step in assisting our financial institutions to compete competitively in overseas markets.

2. Despite efforts by the Japanese authorities in recent years to open their financial system, the fact remains that Japan is far from being the open financial system one would hope and certainly expect of a nation endowed with its economic power and sophistication. Furthermore, structural change currently underway in Japan is making commercial banking less and less attractive to foreign as well as indigenous institutions.

3. Rather than continuing to fight the arduous battle for broad liberalization of Japanese financial markets, an alternative would be to focus our efforts on lobbying for those fee-generating (i.e., non-lending) businesses where American financial institutions have a competitive advantage. Developing a meaningful list of those product niches where we want access in Japan would require close and careful cooperation between our financial industry and those assigned responsibility for enforcing S.2028. Furthermore, such an approach would be welcomed by the Japanese, who continue to be frustrated by our broad-based demands for a "level playing field," a concept which runs counter to their own niche-oriented approach to the financial services industry. In addition, by identifying and advocating select product sectors, we would be helping those of our financial institutions willing to commit the resources required to remain in one of the world's most competitive -and expensive- financial market places.

April 5, 1990

TESTIMONY BEFORE THE UNITED STATES SENATE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

Eric W. Hayden
President
Investors Bank & Trust Company
Boston, Massachusetts

Mr. Chairman:

Thank you for the invitation to appear before this distinguished Committee and to testify on behalf of S.2028, the Fair Trade in Financial Services Act of 1990, which is designed to refine the national treatment standard and to improve the competitive access of American financial institutions to foreign banking and securities markets such as those of Japan and the European Community. My views have been solicited with particular reference to Japan.

I have been involved with the financial services industry for fifteen years, half of which time I spent in Japan with Bank of America. During that time, I participated actively as spokesman for that institution and as a representative of the foreign banking community in its efforts to encourage the local authorities to liberalize the financial system and open the domestic market to foreign financial institutions. During my last two years in Japan, I directed the Bank of America's investment banking activities in that country, activities which were devoted primarily to the underwriting and trading of securities. In my current capacity as President of Investors Bank & Trust Company, I am actively involved in the handling and processing -as opposed to the underwriting and trading -of securities. Although at a considerably greater distance than in previous years, I try to remain closely in tune with the Japanese financial system through courses I teach at Harvard University on capital markets and on current financial events. Additionally, over the years, I have written and spoken about the Japanese financial system, the efforts of Japan to deregulate its economy, and the internationalization of yen. It is my hope that these experiences may, in some small way, assist you as you consider the very important dimensions of this bill.

National Treatment and Reciprocity

I would stress at the outset that I fully endorse the standard of national treatment as the basis for negotiating access to foreign markets. The concept of equal treatment under domestic law promises fair treatment for all sides while also permitting the right of governments to establish the regulatory frameworks they judge appropriate to pursue within their own borders. In adhering to its policy of unconditional national treatment, the U. S. government has ensured full access to our financial markets even when the home countries of such institutions have discriminated against U. S. financial firms, in effect denying reciprocal national treatment. As a result, foreign banking institutions currently control over 25 percent of all banking assets in this country, up from some 10 percent in the late 1970's. Significantly, Japanese banks alone account for some 15 percent of all such assets, including 25 percent of the banking assets in California. Meanwhile, however, foreign banks operating in Japan have less than 2 percent of that country's banking assets, a figure which has actually declined in recent years even as officials from this country and many European nations have stepped up their efforts to pry open the Japanese market for foreign financial institutions.

Our government negotiators have long been at a disadvantage in gaining access for U. S. institutions to foreign financial markets because they lack the power to invoke reciprocity. One of the great frustrations of all of us in the expatriate American banking community in Japan was the realization that any hope for change depended in large part on our ability to persuade the Japanese of the benefits to Japan of such change. It was as obvious to the Japanese as it was to us that, despite the support of our government officials, they had no meaningful levers to use on our behalf. You will recall that, as we were making our first push for interest rate deregulation in Japan, Congress was passing the International Banking Act of 1978, which established the rules under which foreign banks operated in the United States. Regrettably, instead of requiring that American banks abroad be accorded national treatment, the Senate Banking Committee's report on that law acknowledged that:

> The United States has more than abided by the principle of national treatment for foreign banks operating here...In contrast our domestic banks have not always received equal treatment in foreign countries with their host country competitors.

The report went on to note with regard to Japan that "American banks are competitively disadvantaged in Japanese banking markets."

On hindsight, it is, indeed, unfortunate that the concerns of S.2028, which seeks to amend the International Banking Act of 1978, were not incorporated into that major piece of banking legislation. The stress of S.2028 on defining "effective market access" not only in statute but also in actual practice is long overdue. In 1978, when the original legislation was passed, ours were among the largest and

most powerful banks in the world. Two of the world's three largest were from our shores, and we controlled 30 percent of all international loans. A dozen years later, our nation has turned from a creditor to a debtor nation, our largest bank is only 24th in the world in size, and we account for less than 15 percent of all cross-border lending. In contrast, Japanese banks now control 40 percent of international bank assets and account for 17 of the world's 25 largest banks. Meanwhile, the three dozen Japanese banks operating in this country control upwards of $400 billion in assets, while half as many American banks operating in Japan control less than one-tenth as much.

Notwithstanding this erosion in our financial pre-eminence over the past decade, there is still room for our banking and securities officials to use the authority provided by S.2028 to deny applications for regulatory approval filed by banks and securities companies from countries that discriminate against U. S. firms. By amending both the International Banking Act of 1978 as well as the Securities Exchange Act of 1934 to include provisions for national treatment, the Fair Trade in Financial Services Act of 1990 takes an important step in assisting our banks and securities firms to compete competitively in overseas markets.

Reciprocity and Japan: The Current Status

Efforts begun in the late 1970's by the foreign banking community in Tokyo to liberalize the Japanese financial system were given considerable impetus in the mid-1980's with the initiation of the regularly scheduled meetings of what has become known as the U.S. - Japan Working Group on Financial Markets. The latter sessions, which involve officials from both governments, have had significant impact in achieving their objective of a more open Japanese financial system. Accordingly, certain elements of the Japanese financial system of today are quite different from those of the late 1970's.

For example, about half of all bank deposits have been deregulated to reflect market rates. Various new short-term money market instruments have been introduced, including a yen bankers acceptance market and a domestic commercial paper market. Foreign firms have been admitted to the Tokyo Stock Exchange, and foreign banks are participating in the local trust banking business. The government's primary debt security, the 10-year bond, is sold through a combination open market auction and prearranged syndicate to which some foreign securities houses now belong. Finally, the yen has a larger international role, thanks particularly to the expansion of the Euro-yen market, through which Japanese and non-Japanese borrowers can now access yen debt in the same way they have accessed Euro-dollar debt since the late 1950's.

Despite these steps, however, the fact remains that Japan is far from being the open financial system one would hope and certainly expect of a nation endowed with its economic power and sophistication. For instance, regulatory intervention and a limited range of instruments, including the absence of a freely traded

Treasury bill equivalent, have thwarted the evolution of an efficient and liquid money market. Since nearly one-third of all deposits in Japan are at the Ministry of Posts and Telecommunications, whose relatively cheap funds are used to finance the government deficit, there is little internal pressure at the policy level to foster a competitive short-term market. Likewise, while an auction process for government securities has been established, it is still quite limited. Further, the ability of foreign investment management firms to manage Japanese investment trusts, the Japanese equivalent of mutual funds, is constrained by several onerous criteria which I understand will be examined in the testimony of others appearing at this hearing.

Finally, and perhaps most importantly, foreign financial firms remain frustrated by the lack of transparency in the process by which official regulations, policies, and administrative guidance are developed and implemented by the Ministry of Finance and the Bank of Japan. Clearly written policies remain the exception rather than the norm, thereby ensuring the bureaucracy monumental power to interpret the law as it deems fit, which includes the ability to intimidate financial firms. One phone call is all it takes to make a point and keep the recipient in tow.

In speaking with representatives of major American banks and investment firms about their reluctance to testify at this hearing, I was once again reminded of the inordinate power of the Japanese financial authorities. Foreign securities houses -having recently gained some access to the government bond syndicate, the fixed commission structure of the local brokerage industry, and membership on the Tokyo Stock Exchange -have on more than one occasion expressed their reluctance to press for further openings lest they risk what little they have managed to gain after years of advocacy. In the case of the present hearings, they have decided to let well enough alone. Having recently been allowed to participate in the cartel-like arrangement of fixed commissions, they apparently savor being on the inside after years of being outsiders.

Likewise, foreign banks remain as dependent as ever for their funding upon the interbank market, which is subtly yet decisively controlled by the authorities in the same way as reserve requirements and quarterly lending ceilings. No doubt, foreign banks still recall the unfortunate backlash from our arguing in the late 1970's for a more open financial system. Our advocacy of interest rate deregulation and easier access by foreign banks to short-term funds resulted in the Japanese financial authorities allowing local banks to offer foreign currency (or "impact") loans, a product which had until that point been our exclusive monopoly. Within two quick years, we had lost virtually the entire market for this product and, with it, a significant portion of our profits.

But besides the inordinate power of Japanese financial authorities, there is another important factor limiting foreign banks' ability to compete in Japan. Unfortunately, that factor is unlikely to be influenced by either these hearings, or quite probably, anything within the power of the United States government. I refer to the

structural change underway in the Japanese financial market which has fundamentally reduced the profit potential of all commercial banks, indigenous and foreign.

Banks operating in Japan are facing higher funding costs in the wake of interest rate deregulation, a phenomenon which also affected this country as we replaced Regulation Q and permitted banks to compete with the money market funds. Meanwhile, as bank funding costs have risen in Japan, Japanese firms have simultaneously reduced their historic dependency on bank borrowings. There are several reasons, including particularly:

- the increase in retained earnings which have accompanied the surge in Japanese corporate profits in recent years;
- cheaper access to equity funding made possible by the phenomenal boom in the Tokyo Stock Exchange over the past several years; and
- easier access by Japanese firms to the global capital markets, including the Euro-yen market, in no small part the result of American-led pressure.

As a consequence of this structural change, commercial banking, always a frightfully competitive endeavor in Japan, has become even more so. In response, Japanese commercial banks are turning from their historic focus on the wholesale end of the market and concentrating increasingly on the profit potential of retail banking. In addition, they are aggressively looking to expand offshore, particularly in this country and in Europe, the latter having become especially attractive as 1992 approaches.

Where does this leave foreign banks, particularly American banks, in Japan? Their focus has always been the corporate market, particularly those companies with international interests requiring either export financing or offshore working capital. But as Japanese banks have expanded their offshore capability, Japanese firms have increasingly used Japanese banks in lieu of, say, American banks. Cross-shareholdings, financial keiretsu relationships, and the abundance of Japanese banks operating in this country have all conspired to push Japanese corporate borrowers away from American lenders.

In Tokyo, meanwhile, American banks are in the process of reassessing their commitment to what is clearly an overbanked and unprofitable market. Five years ago, the 80-odd foreign banks accounted for some 3 percent of bank loan assets; today, that relative share has shrunk almost in half, and it continues to fall. In short, added to the historic problems of foreign banks -e.g., limited access to local funds, restricted branching opportunities, onerous regulatory intervention- are the sober realities of a shrinking market and steadily soaring costs. It is particularly the latter, the result of a strong yen and high fixed operating expenses, which have led several major American banks to scale back, shut down, or re-focus their Japanese operations. Further, because of the extraordinary price of acquisition, no American bank is, to

my knowledge, even remotely considering the purchase of a local bank's branch network.

Reciprocity and Japan: The Next Steps

Liberalizing Japanese financial markets has been a top priority of this country for several years. It is certainly an important objective of this Committee as evidenced by its consideration of the Fair Trade in Financial Services Act of 1990. Pushing Japan toward a more market-driven financial system would obviously be consistent with American-style capitalism. But can we succeed? And if so, can we expect foreign financial institutions will necessarily get a larger share of that country's financial market pie? Despite our efforts to force the Japanese financial system "open", it remains frustratingly "closed". True, as has been already noted, we have made some gains; reality, however, is that we have been thrown little more than a few bones. Despite formal changes, the financial system continues to fuel Japanese economic growth by ensuring ample capital formation at bargain basement prices. Financial market liberalization has proved to be no different from Japan's steps to "liberalize" its retail, agricultural, or high technology sectors. We can pound the table and come home with some victories, but we never seem to win the real fight of obtaining meaningful access for our financial institutions to the Japanese market.

Instead of trying to remake Japan in our own image, perhaps it might be more appropriate to accept the fact that Adam Smith's invisible hand does not extend to Tokyo. What the Japanese judiciously call "administrative guidance" is actually the embodiment of an economic system quite different from our own brand of laissez-faire capitalism. Theirs is a system in which government bureaucrats play a vital role in keeping the peace by ensuring that the various participants retain their respective niche roles. In the world of finance, that means neatly defined roles separating the banking industry from the brokerage industry, the short-term lenders from the long-term lenders, and lenders from the trust bankers.

Obviously, the United States can take the powers provided by S.2028 and demand that, if American financial institutions are not given open access to the Japanese financial system, then Japanese banks or securities houses will be denied applications for regulatory approval in this county. But given the strategic reassessment currently underway at most U. S. commercial banks operating in Japan, do we really want to arm our Treasury officials to fight for the Model-T in the era of the turbo jet? However, perhaps a more appropriate tactic would be to accept the reality that Japan's is a financial system in which each participant has a definable market niche.

In short, instead of continuing the arduous battle for broad liberalization of the Japanese financial markets, an alternative would be to focus our efforts on lobbying for those product niches where our financial institutions have a competitive advantage. For instance, we might take a clue from Bankers Trust or J. P. Morgan and narrow our demands to areas which support the strengths of our

banks in such fee-generating (i.e., non-lending) areas as risk management, leasing, and trust banking.

Likewise, our banks have a potentially major role to play in the development of a viable corporate debt securities market in Tokyo. Reflecting the niche nature of the financial system, Japanese corporations have traditionally raised their debt through bank borrowings and their equity through issues underwritten and placed by the securities houses. As distinctions between commercial and investment banking erode in the United States, particularly in the area of debt instruments, our banks are developing valuable expertise which could be effectively deployed in Japan. As compensation for their minimal (and eroding) commercial banking market share, they ought to be allowed the exclusive privilege of underwriting and distributing debt instruments -much as they were permitted the exclusive right to make impact loans for 30 years after the end of World War II.

Whether we precipitate the development of a viable corporate debt securities or whether the Japanese do it themselves, they will ultimately need a book-entry system of handling securities to replace the heavy predominance of physical delivery. This could open up opportunities for American banks to sell their custodial services in Japan.

Developing a meaningful list of product niches in which American financial institutions ought to be permitted access in Tokyo would require close and careful coordination between Treasury and our financial industry. But such an approach should be welcomed by the Japanese, who continue to be frustrated by our broad-based demand for a "level playing field". In an economic system where everyone has a specific and narrowly defined market niche, this demand is an alien -and meaningless- concept. If we are ever to have a significant role in Japan, we need to accept the fact the Japanese set the rules. If we want to compete effectively in their market, we need to revise our fundamental approach and acknowledge that their brand of capitalism is different from ours. Once we have done that, S.2028 will provide our government officials with an effective means to extract gains that are both realistic and meaningful for our financial institutions.

Thank you, Mr. Chairman, for the opportunity to present my views to your Committee.

The CHAIRMAN. We've had three excellent statements. Thank you, and we're grateful to have them all.

Mr. Pauli, we've just been looking at this book that you are coauthor of, called "The Second Wave." We'd like to hear from you now.

STATEMENT OF GUNTER PAULI, CHIEF EXECUTIVE OFFICER, EUROPEAN SERVICE INDUSTRIES FORUM, BELGIUM

Mr. PAULI. Thank you, Mr. Chairman.

The CHAIRMAN. Please pull the microphone just right over, if you will.

Mr. PAULI. Thank you, Mr. Chairman.

I'll be talking here not as a banker; I'm talking here as a member-elect of the European parliament. I'm talking here as someone who has been advising Director General Three of the commission of the EC for the last 4 years on identifying exactly how are the European service industries positioning themselves competitively and how can they maintain and even expand their competitive edge world-wide.

So the four questions you addressed to me, I will skim over them.

First of all, I think it is clear, like it has been indicated here before, the European Community wants absolutely and has already enacted, as you know, in the Second Banking Directive several paragraphs which will permit the commission of the EC, first, to negotiate. Second, to negotiate. Third, to negotiate. And if that doesn't work, to retaliate.

And I think it's very important that we have specifically inscribed in there negotiation and negotiation and we should negotiate very hard.

But when we will have as of the first of January, 1993, the most liberal move around the world for all financial markets, we think it's not more than fair that we would have the leverage that is necessary in order to gain access to other markets as well.

Anyone can obtain a license for 13 banking services. They will only have one authority to report to and operate in 12 countries. Anyone that already has a license in the country will maintain that. We will not take it away. But anyone who is applying for new ones, they will have to face the ballgame that we're putting the rules in for.

So the commission of the EC has complemented that with a merger controls directive, in which we also are requiring as of the first of January, 1993, reciprocal national treatment.

What does it mean? That if one of our banks, for example, can say, we cannot buy a Japanese bank, that the Commission of the EC will have the power to negotiate with the Japanse in order to have access to the acquisition market in Japan, because, otherwise, the Japanese will be able to buy any bank they want. And we want to avoid that.

If we cannot buy a bank in your country, de facto on the market, sorry, we can block an acquisition in our market from your side.

I think U.S. negotiators do not have to be afraid of Europe because we have in the Second Banking Directive 9.3, where it is on comparable market access, which means that, in specific terms, the

Glass-Steagall Act and the McFadden Act, which some people of the commission of the EC do not like very much, that we can negotiate and we have the power to negotiate, but not to retaliate.

So there is a slight distinction, but I think it is an important one.

I think U.S. negotiators are at a great disadvantage in not having any stick behind the door. It is clear that if you want to negotiate with the Japanese, you want to negotiate from a power of strength. And a power of strength that means that you show that you know what you want, in the first place, and second, that if you can't get what you think is not more than fair, that you should get, that you can indeed ask for reciprocity and retaliate.

Liberalizing the Japanese market means, very concretely, negotiate from a position of strength, or don't negotiate at all.

And I think the U.S. Government has no position of strength today.

The following point is very important, that the Japanese have very often used requirements of the American Government and the European Government in order to serve themselves.

Let me give you a couple of examples.

Giving 22 licenses on the Tokyo Stock Exchange to foreign brokers and banks, preferably, yes, the Japanese, after having been kicking and screaming for years, said, yes, we will do it. But they would have preferred, of course, 22 foreigners than 22 Japanese banks on the Tokyo Stock Exchange. And that gave the brokers a leverage with their own Ministry of Finance to be able to say, look, you just forced these 22 foreigners in. Don't ask us to let Japanese banks in because that's what they're really afraid of.

On top of that, Salomon Brothers is earning $80 million U.S. dollars thanks to fixed commissions. Don't ask them to testify here. They will never do that. They're the first ones to make $80 million in Japan on the Tokyo Stock Exchange, thanks to fixed commissions. Don't ask them to liberalize the Tokyo market. It's against their advantage.

Second, when the Japanese do give in on certain areas like it has been the case in pension funds, let us be very clear. They have given it to serve their own interests. Trust banking, pension funds, is an area in which we do have a particular expertse. But what did they do?

After long pressure, they agreed, yes, you can come in. But they put into the law a very small paragraph which said, you had to have 5 years of effective experience on the Japanese market in order to be given a license.

Now, let's be honest. If you weren't allowed in the market before, and you can't do headhunting in Japan. We know that we cannot do headhunting. How in the hell will you be able to get the experience you need to get the license? What's the result?

Everyone who got into the market went through joint ventures. With whom? With Japanese trust banks.

I call that using a computer with two disk drives. One empty, one full. Push the button, copy. The full one to the empty one, the empty one to the full one.

This is what's happening.

Third point. If the Japanese liberalize, let us focus on those markets that they're liberalizing, markets in which they themselves

are not interested any more. Corporate lending. Look at the strategy definitions of the major Japanese banks. They're not interested in corporate lending in Japan. They're not making money. They're not interested in consumer financing. It's not in their interest. They're not making money themselves.

So let's liberalize it. And I think that this is a strategy that has been a pitfall on our side.

We, and I say we, that's we Europeans and you North Americans, we have not identified clearly enough, and I fully support what Mr. Hayden said. We have to know what you want. That area in which we're strong, we have to focus on, because if we will go for full-fledged, all-out liberalization, it may be detrimental to our own objectives. They may then move business back to Japan because they can bang Japanese bankers cheaper here—Japanese banks can bang Japanese cheaper in the United States than they can bang Japanese in Japan.

If they're liberalized, they will be able to bang Japanese in Japan the Japanese way.

Finally, I think it is important to look at reciprocity in a more broader sense than just financial services. Let me give you an example.

Credit cards. And in this I'm quoting from an interview of March 29, just last week, of the senior vice president, Mr. Murata, of JCB. JCB wants to have 500,000 clients in North America by the end of the year. And what did he say?

With domestic sales in Japan rising 30 percent annually, we can afford to finance international card operations. Moreover, he goes on, we are not allowed to offer revolving credit on the credit card in Japan. But we could use low-cost Japanese financing to use to issue cheap credit cards in Europe and North America.

No need to say, American Express does not have access to the cheap financing, does not have access either to the Japanese market for credit cards.

Reciprocity needs to be broadened also in another area. Financial services depends on information services. Financial services depends on telecommunications. Financial services depends on software.

Let me give you one last case which is very important. Reuters. And I hope they're here and I hope they're listening because they themselves have not noticed it at all in the public.

Reuters has direct access to the Tokyo Stock Exchange with a direct link, telecommunications link, at 2400 bps, bits per second. Quick, which is owned by Nomura Securities, and Nomura also has the largest software company, Quick, owned by Nomura Securities, by Hitachi, by the Nihon Keizai Shimbun, has a direct link to all Tokyo stock exchanges and regional exchanges at a speed 20 times higher. Twenty times higher.

That means if you today want to be a real power in the world market for financial services, you have to have the Quick service, which is quicker, because they have about two to three minutes' edge on the Reuters screen.

Everyone will have to have a Quick screen. And once you're in, that's the strategy. From there on in, they belong.

If you want to do a financial service with your bill, I think, indeed, press for it, and the Japanese will already feel the heat blowing down their neck and will go for it.

But, moreover, look also at adjacent services which are strategic interests. Without that, you cannot compete.

To conclude, the commission of the EC has a directive, a Second Banking Directive.

Second, the commission of the EC has a merger control directive.

And third, the commission of the EC has now the authority to have an audit made of foreign investments in Europe to make certain that there are no tit-for-tat deals like the Nissan factory is a specific case in the United Kingdom, where they didn't pay a penny to get the factory.

We want to avoid our European countries to fight against each other and oversubsidize foreign investments. And I think we see a similar case here in North America.

To conclude, if you, as the U.S. Senate, would pass a bill which in its concept on reciprocities, comparable to the one in the EC, we would have quite a powerful act and quite a leverage to coordinate action to different markets which are not granting reciprocal national treatment.

Thank you.

[The complete prepared statement of Gunter Pauli follows:]

US Senate Banking Commission

Hearing
on the
Fair Trade in Financial Services Act

Washington DC April 5, 1990

Presented by Gunter PAULI
CEO of the European Service Industries Forum
Secretary General of the European Business Press Federation
Member-elect of the European Parliament (1989-1993)

Background

My intervention today is not one of a banker, it is by someone who has been monitoring the Japanese strategies in financial services, electronics and the automotive industry for a decade. I started my career in Japan in 1980 when I worked as junior staffer at the Belgian Embassy in Tokyo. I was asked to identify new ways of penetrating the Japanese market. After six months at the Embassy, I established my own company advising Western ooorporations operating in Japan. I maintained my residence in Japan untill 1987. Over the past few years I have published extensively on the issue, and became an advisor to major banks and manufacturers on how to deal with Japanese competition worldwide. Those ideas were summarized in the book "The Second Wave : Japan's global assault on financial services" , which I wrote together with Prof. Dr. Richard Wright, professor of international business from McGill University in Canada, a person with a broad Japanese experience.

Since 1987 I have been retained on a regular basis as an advisor to the Commission of the EC, directorate general III, in charge of industry and the internal market, in my capacity as CEO of the European Service Industries Forum. It has been my responsibility to assist the Commission in identifying the EC companies' competitive role in the service industries and design policy

options to secure a strengthening of their competitive edge. During the elections for the European Parliament in June 1989, I was confirmed as first member-elect of the Flemish Regional Party. My constituancy was Flandere, the Northern part of Belgium.

Basic Position on the Fair Trade in Financial Services Act

I fully endorse the proposal of the Fair Trade in Financial Services Act, though believe it is only a first step in the right direction and more is needed to reach the proposed objective: DE FACTO MARKET ACCESS. My intervention is not a advocacy for protectionism, but is rather an effort to share on the basis of my working experience some thoughts on how you could empower the US Treasury with tools comparable to those of the Commission of the EC and WHY.

Do most European nations follow policies of unconditional national treatment by which foreign financial institutions are granted full access to their markets regardless of whether the home countries of any such institutions discriminate against their financial firms?

Today majority of the European nations do not offer unconditional national treatment. Greece and Portugal grant the least access. On the opposite side, smaller countries such as Luxembourg, the Netherlands and Belgium have a policy promoting the establishment of foreign financial institutions even when they have no access at all to those markets. Due to the sheer size of their financial institutions, they often lack the ambition to penetrate foreign markets anyway. By the end of this year, some 21 Japanese banks will have established shop in Brussels, whereas only 4 Belgian banks took up a license in Japan.

What policy has the European Community adopted in its Second Banking Directive and its Merger Control Directive toward foreign financial institutions from countries that do not grant EC institutions de facto national treatment?

Whatever rules nations apply today, as of the first of January 1993, the second banking directive will have been translated into a law in all 12 member states of the EC. The second banking directive foresees that

(1) that anyone can obtain one license and operate 13 different financial services across the 12 member states,

(2) that anyone already having a license will maintain all rights and privileges of that license

(3) that the Commission of the EC has the right to negotiate with third countries that discriminate, i.e. do not grant de facto national treatment, against EC firms in financial services and can propose to the Council of Ministers for retaliation (as stipulated in article 9.4).

The Merger Controls directive, which was accepted last December gives the Commission exclusive powers to investigate mergers involving companies with a combined worldwide turnover of al least 5 billion ECU if the aggregate EC-wide turnover of each of at least two of the companies is greater than 250 million ECU. All other mergers will fall under the jurisdiction of the national authorities where such authority exists (currently only UK, Germany and France have enforcement bodies).

All 12 member states also agreed to the reciprocity clause in the Merger Controls Directive which will allow the Commission of the EC to negotiate with third countries that discriminate against EC firms involved in takeovers or mergers in third markets. Banks and insurance companies will also be subject to the new rule: the banks threshold will be based on one-tenth of the banks' total assets; the insurance company threshold will be based on one-tenth of net premiums.

Do you think that US negotiators are at a disadvantage in gaining access for US institutions to foreign markets insofar as foreign officials know our government has no reciprocal powers?

Of course ! And that is why the EC has adopted its article 9.4.

The Market

The last five years, the Japanese have taken leadership in the world market for financial services. Nine of the 10 largest banks in the world are Japanese; the 5 largest brokers are Japanese; the largest insurance companies are Japanese; the largest institutional investors are Japanese: already 10% of the NYSE is controlled by Japanese brokers; 40% of the Eurobond market in London is controlled by the Japanese; and the Japanese have by the end of 1991 some 21 banks in Brussels, more than there are fully owned Belgian banks.

The rise of the Japanese on the international market tells us we should study the reasons for this success and analyse the strategies applied. In our book "The Second Wave : Japan's global assault on Financial Services", Prof. Dr. Richard Wright and myself predicted four years ago that the Japanese will focus especially on those services which are :

standardized
high volume
low value added per operation
technology intensive

This is exactly what they have done and will do: just monitor credit cards, eletronic financial information, courier services and the like.

How to liberalize the Japanese market ?

The Japanese have respect for someone who negotiates from a position of strength and who demonstrates that he is willing to use the authority with which he has been empowered. When Prime Minister Thatcher threatened to revoke Japanese banking licenses in the UK, even when she technically did not have the authority to do so, the Japanese quickly give in to her demands. Dr. Umberto Agnelli, chairman of FIAT Auto wrote in his foreword to the Italian edition of our book : "A clear uncompromising language, a position of strength, a well defined objective and *a willingness to negociate hard but always negotiate* is the key to success". Either you negotiate from a position of power, or there is no negotiation at all. You end up asking favors. That applies in particular to negotiating with the Japanese for market access.

The 4 pitfalls of liberalization

The lack of authority has often permitted the Japanese to use the exchanges of talks with the Europeans and the Americans to offer arrangements which in the end did not meet the objectives we had proposed for ourselves in the West.

(1) **Giving licenses to foreign brokers on the Tokyo Stock Exchange was a way out to the tremendous pressure to let Japanese banks in.** The Japanese brokers rather prefer 15 foreigners than 15 Japanese banks operating on the Tokyo Stock Exchange. On top of that, ever since companies, like Salomon Brothers make more than a billion Yen on fixed commissions in Japan, the Japanese have strong allies in North America fighting against liberalization of the Japanese financial markets. These companies have a vested interest and will see no need for any action, as proposed by you today. The Japanese arrange a profit of 100 million US$ for an American broker in Japan and so secure a loyal ally.

(2) Or, the **Japanese officially give in, but in the end get all our know-how and business.** That is what happened with pension funds. We urged them to open up this market, and the Japanese did. Though, they included a clause requiring a minimum of five years of experience in Japan in order to get a license. As it was forbidden for foreigners beforehand and headhunting Japanese staff is just about impossible, 8 of the 9 licenses were granted to joint ventures: the cheapest way for the Japanese to learn how to do trust banking. And we organized press conferences telling the world how the Japanese gave in to our pressure.

(3) Or, **the Japanese liberalize, and they open up markets in which the Japanese themselves are not interested anymore.** Lending to corporations in Japan is free for all, but even the Japanese banks are not interested in that business. Getting into the market is not so difficult, earning money is another ballgame. In 1989, the foreign financial institutions in Japan did not even earn an average 1 million dollars each.

(4) If you negotiate for market access, you have to know exactly what you are aiming for. On the basis of a first hand view on the strengths and weaknesses of your own financial institutions you target specific sectors. Because an all-out **Japanese market liberalization, then our key financial markets will be badly affected.** Why? Because, today the Japanese bank Japanese companies abroad more efficiently. Our markets are more free, more efficient and cost effective. But once the Japanese market will really liberalize, then the *Japanese can bank the Japanese in Japan.* And if our financial institutions were not prepared, then an estimated 50% of the business the Japanese undertake on our markets goes back home, without us being involved.

If the US Treasury would have comparable powers as the Commission of the EC will have as of 1993, then you would have had the possibility to negotiate, and negotiate hard for market access and which would benefit directly your financial institutions.

Do yo think that financial institutions from some foreign countries are strengthened to compete in the US market by the fact they do not have strong foreign competitors in their own markets?

Indeed, so. Take the example of JCB credit cards. This Japanese credit card was established in 1962 by Sanwa Bank in cooperation with American Express. The agreement has long expired. Now JCB wants to sign up North

Americans and Europeans. They will not charge a membership fee and Mr. Kazunao Murata, JCB's senior vice-president indicated in an interview on Friday March 29, 1990, that "with domestic sales (inJapan) rising 30% annually we can afford to finance international card operations" and he goes on "we are not allowed to offer revolving credit (on the credit card) in Japan, but ... we could use low cost Japanese finance to issue cheap credit cards in Europe (and North America)". No need to indicate that this cheap funding in Japan does not benefit American Express.

Reciprocity needs to be a broad concept in financial services. Financial institutions from some foreign countries are strengthened because several key success factors in the financial services are accessible to them at much lower cost. Indeed, financial services will only compete effectively if they are supported by sophisticated software, telecommunications and quick information. Nomura Securities controls Japan's largest software company, owns the fastest expanding electronic information network and operates the largest dedicated telecom network in Japan. If you can crunch out 3 billion US$ in profits a year thanks to a protected home market, and fixed commissions, you can prepare yourself for world dominance in financial services, information, financial software and telecommunications.

Quick, a joint venture between Hitachi, Nihon Keizai Shimbun Japan Economic Journal) and Nomura, wishes to take over the lucrative market for electronic financial information. It receives its information directly from the Tokyo Stock Exchange at 48,000 bps. Reuters is also linked to the Tokyo Stock Exchange, though at a transmission speed of only 2,400 bps. Quick is indeed *quicker*. Which broker, who respects himself on the market can permit NOT to have a Quick screen in the dealing room. And once Quick is in the dealing room, you and I know how they will take over in the long run. We have called this strategy the TERMITE STRATEGY. Nibble on markets which are of marginal, -though of strategic importance- and when we notice what happens ... too late!

While you are attempting to open up the fianncial markets in Japoan, you should not loose sight of the telecommunications, information and software market.

The response of the Commission of the EC

The second banking directive foresees a de facto reciprocity for financial services. If the US Senate would pass a similar concept of reciprocity as the Commission has done, it would become a strong tool to force the Japanese to open up and let our financial houses get a fair share of the enormous profits generated on the market.

On top of that, the EC is preparing an investment related directive which will effectively block over-subsidization of foreign investments whereby different EC countries compete each other. In the end, it is the tax payer and the consumer who ends up footing the bill for such subsidies. These two clauses effectively block foreign investors from making deals with individual countries and offers a leverage which can be used effectively on the condition that the Europeans know what they want.

Conclusion

Assessing the Fair Trade in Financial Services Act, I cannot but endorse it, though hope that you will consider a broader range of initiatives in the US Senate and will consider some form of coherence with the

Commission of the EC's directives aimed at forging a true free trade system around the world.

Thank you.

Gunter PAULI
B-2850 Keerbergen
Belgium
tel: (32 15) 51 7080
fax: (32 15) 51 4902

as of May 1, 1990
" 't Hooghuys"
B-2590 Berlaar
Belgium
tel.: (32 3) 482 47 91
fax: (32 3) 482 47 96

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The CHAIRMAN. Thank you very much.

Senator Garn has asked to go first. He has a time constraint.

Senator Garn?

Senator GARN. Gentlemen, I thank you for your testimony. I do have to leave. I simply would ask the committee staff if they would make certain that the testimony of each of you is delivered to Mr. Mulford.

Thank you very much. [Laughter.]

The CHAIRMAN. Senator Shelby?

Senator SHELBY. Mr. Chairman, I appreciate your indulgence.

I agree with what Senator Garn is saying here. Mr. Hayden, I was really impressed with your data here.

You've lived in Japan. You said that.

Mr. HAYDEN. Yes.

Senator SHELBY. You're in the banking business, some form of it right now.

Mr. HAYDEN. Yes. I've been in banking for 15 years.

Senator SHELBY. You also teach as an adjunct. Is that what you do? Harvard Busines School.

Mr. HAYDEN. Yes, I'm at the Harvard, extension.

Senator SHELBY. I want to share for the record—I wish this under secretary was here—just some of your numbers. I assume they're right.

On page 2. As a result—we're talking about discrimination—as a result, foreign banking institutions currently control over 25 percent of all banking assets in this country, the United States, up from 10 percent in the late 1970's.

Significantly—and these are your words—Japanese banks alone account for some 15 percent of all such assets, including 25 percent of the banking assets in the State of California.

However, foreign banks operating in Japan—and I guess that's EC banks——

Mr. HAYDEN. Yes. 82 foreign banks.

Senator SHELBY. Have less than 2 percent of the Japanese banking assets, a figure that you say has even declined in recent years.

Now Mr. Pauli made a reference, too, that what they're letting us into is stuff they don't really want.

Do you want to comment on that, on the numbers? I assume the numbers are right.

Mr. HAYDEN. The numbers are correct, yes, sir. The reality is that commercial banking is becoming less and less attractive for anybody, Japanese banks and foreign banks.

Senator SHELBY. Where is the administration on this? You sat in here, all of you, earlier and you heard the testimony, as Senator Garn said, and Senator Riegle, our Chairman, has been on this committee much longer than I have. This is my fourth year. and I've heard similar testimony. They've heard it for many, many years.

But the reality is we're losing this part of the economic war, just like we were losing and are still losing the industrial products.

Is that correct, Mr. Hayden?

Mr. HAYDEN. I would agree entirely, sir. The Japanese are as determined to dominate the world of finance as they dominate the

world of high technology, automobiles, steel, shipbuilding, et cetera, et cetera.

Senator SHELBY. But where is the administration? Are they asleep? Are they going to wake up? I hope, as Senator Garn says, that they will read your testimony, all of you, and so forth.

Thank you, Mr. Chairman.

The CHAIRMAN. Did you want to respond to that question? I mean, what is your sense for what the Executive Branch strategy is?

Senator SHELBY. Are they asleep? Are they timid?

Mr. HAYDEN. I'm not really qualified to judge. I can best comment on the business aspects and the economic aspects.

Senator SHELBY. They're not doing much, are they?

Mr. HAYDEN. They don't appear to be, no.

Senator SHELBY. The figures—your figures speak for themselves.

According to these figures, this administration is not onto the problem, or at least the numbers don't show it.

Mr. Pauli?

Mr. PAULI. Looking at it from a European perspective, when there is a small problem, for about $150 million U.S. dollars of exports of meat, they talk about trade war with Europe. But when you talk about the financial services, no one shows any interest to act in the Executive Branch. Neither on the European side—I mean, from the United States towards Europe.

Senator SHELBY. Do you believe, Mr. Hayden, that this administration, if it, as has been described by certain people in the press, as a caretaker, don't tilt the boat, don't rock the boat, if they don't rock the boat in this, what's going to happen to us in the financial services?

Mr. HAYDEN. Well, I think the concern of the administration may be that there has been a great deal of Japanese investment in this country, from real estate to the stock market to the financing of our Government deficit.

Senator SHELBY. Sure.

Mr. HAYDEN. I think some people are concerned that if we rock the boat, the Japanese will withdraw. I find that difficult to accept because the Japanese are more than a little bit pregnant. They own our real estate, our stocks, and our Treasury instruments. They're not about to dump and run, because if they do, they will create the world's greatest financial catastrophe that we've ever seen.

So I think they're here, for better or for worse, for the long haul. They have little choice. So I think this is the ideal time to play hardball. Let's tell them, "It's time to open up your system. We find it unconscionable that some of the greatest banks in the world used to be American, and they're no longer American."

Senator SHELBY. And if they're trading with us 50 percent of their exports of services and goods, we're their market.

We have some real Aces to play, don't we?

Mr. HAYDEN. As a businessman, I always find I have the greatest influence with my largest supplier.

Senator SHELBY. OK. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Very good. I think that establishes a very important part of the record.

Mr. Pauli, let me address this to you. Mr. Hayden states on page 4 of his testimony, that he has spoken with representatives of major banks and investment firms about their reluctance to testify in favor of our bill, S. 2028. He concludes that their reluctance is based on the fact that many have a profitable, although a small, niche in the Japanese market and are therefore, insiders, and they just don't want to make any waves.

Such caution, he surmises, may be reinforced by their fear of what they would consider to be the tremendous power of Japanese financial authorities.

I'd like you to react to that. Do you think that's a valid observation?

Mr. PAULI. I think it is indeed very valid. Nomura Securities makes $3 billion net a year in Japan, which gives an interesting opportunity to diversifying different businesses.

To safeguard certainly the brokerage business at this stage, the four big brokers will do anything to make certain that their privileged markets will be maintained and will be shielded off first—and I repeat—first of all from competition from Japanese banks. And in order to avoid further competition from Japanese banks in the brokerage market, due to their article 65, they will need allies. And allies they need are for financial institutions, which they will keep a small piece of the market, for which they will first hand—yes, give some profits away, but marginal profits.

If you make $3 billion a year, no problem to give about $80 million to someone else.

But second——

The CHAIRMAN. Just a few crumbs to feed the dwarfs over here.

Mr. PAULI. Yes. But second, in the meantime, you gain all expertise from those financial institutions.

I think this is worse. I have never known a market in the world—I have lived 7 years in Japan. Seven. And I've never seen a market where we have given free of charge our financial services know-how like we've done in Japan.

The Japanese always have offered to us, and were, unfortunately, dumb enough to accept, always offered to us personnel on a 3-year lease basis. So you have the Japanese work for our foreign banks in Tokyo for 3 years and then they go back to their own bank.

That's the way we've been operating and that's the way it still works today.

Why? Because we don't speak enough Japanese. We've got to be honest about it. We do not know the language in order to operate there.

The CHAIRMAN. Right.

Mr. PAULI. But taking that for granted and seeing how it's working, I think we, indeed, have to be very wary of how the Japanese are great lobbyists. They know how to make lies and they know how to give enough power in order to have it for the future to come.

The CHAIRMAN. They know how to work this town. You know, it's very interesting. I'll give you an illustration that's not just Jap-

anese, but they're the prime force. And this is just an applied example of that point I've just made. And that is, in the last U.S. Senate campaign cycle, one of the new political action committees that's come into being is the foreign car dealers.

Last year, or in the last campaign cycle, this relatively new pac, which, of course, would have as its greatest source of strength the Japanese car makers and sellers, raised and contributed in campaigns for the U.S. Senate, more money than General Motors, Ford, Chrysler, and the United Auto Workers combined.

So it's just an interesting side application of targeted force and power and strategy that says, this is a place where we can come in and apply leverage on the decision-making process.

And, as a matter of fact, in tracing where those contributions went, and how they were spent—and some were spent in large blocks right at the end of the election, they actually appear to have changed the outcome of some U.S. Senate races.

So I think we see it in a lot of different forms. I made a passing reference earlier—Senator Shelby would also know and be aware of articles that are now being done in the general awareness of the number of high-powered lobbyists in this town. I mean, the top guns, the top legal guns in this town who are now on retainer at very substantial amounts of money, to foreign clients, but with a very heavy weighting to Japanese foreign clients.

The power of that institutional lobbying skill in this town—I mean, we're a free enterprise system, and so if you want the top lawyer in town to come in and sort of try to bend the process or lean on the process, and you can come in and hire that talent if you've got the checkbook that's big enough and strong enough to hire that talent, then that talent goes to work for you.

I mean, there's no loyalties between checkbooks. It's a question of which checkbook shows up and has the biggest numbers in it.

So, we're seeing it taking place there as well. And so, when you start looking at all of the entry points and all of the pressure that's being applied, and then come back and hear Mr. Mulford today, who I happen to like and have a high regard for, come in, and it becomes obvious that the administration itself is so reluctant to find a prospective tool with which to work—they don't have to use this tool—just have one.

I mean, it's almost like it's radioactive and they have to move away from it because even the concept seems to be alarming.

I don't know when we're going to wake up to what's happening here because our future is at stake. The great concern that I have is that, in this kind of a system, the people ultimately are going to hold everybody accountable and they're going to say, well, where were all of you? And what did you do and what didn't you do, and why?

I think those are very powerful questions to which we don't have very good answers right now in terms of the performance of our national government over the last several years. And we seem terribly timid.

Part of it goes back, I think, importantly, to the point you make, and that is, if we're not smart enough to train enough of our own people to be able to speak the foreign languages—you're fluent in six yourself—if we don't have enough Americans who are willing to

learn how to speak Japanese and how to speak French and speak Spanish and speak other languages around the world, we're not going to be in a very good position to work in a world economy, in a global economy.

You know, the world is not going to just accommodate to the fact that we don't want to stretch ourselves to the point of learning how to speak the languages of other nations.

So there are certain things that we must do in terms of jacking up our own internal performance in a number of different areas.

Senator SHELBY. Mr. Chairman, could I make a couple of observations?

The CHAIRMAN. Yes, please.

Senator SHELBY. I agree with what the chairman is saying. He's been here and he's the chairman of this committee and spent years on this and spent a lot of time on trade.

I want to ask Mr. Hayden and Mr. Pauli, perhaps others at the table, if you know. They have lived in Japan. Do any nations in the world have a lobby? Do we, Europe, the EC? Do the Americans have a powerful lobby in Tokyo lobbying the Diet on behalf of American interest in any way comparable to what they have here, the so-called Japanese lobby?

Mr. Hayden?

Mr. HAYDEN. Absolutely not. Absolutely not. Nothing comparable.

Senator SHELBY. Mr. Silver?

Mr. SILVER. I think it's a closed market.

Senator SHELBY. It's a closed market. Mr. Pauli, you lived there.

Mr. PAULI. Well, we don't have a lobby, but I nevertheless know several countries which have been very effective, more effective than others.

Take the United Kingdom. Margaret Thatcher is the one who, often without having the right to do it and without having the authority to do it, threatened the Japanese. For example, she threatened to revoke banking licenses of the Japanese at one point in time.

Senator SHELBY. And it worked, didn't it, to some extent?

Mr. PAULI. It worked in telecommunications. She didn't use it for financial services, as such. She wanted to get Mercury into the Japanese market for telecom. And by threatening to revoke banking licenses, she got Mercury into telecommunications.

That's why I'm saying, some of them do. The French have done it. In 1983, they told the Japanese, from now on, all imports will go through Poitier.

Now, any of you who have been to France and have been to Poitier, it's a town of 80,000 people, where it's got four customs officers. And all Japanese imports had to go through.

You should see the flow of investments and agreements and proposals from the Japanese immediately. But I think very often, the Japanese are more subtle. Like the case of Reuters. And I mentioned it explicitly because Reuters keeps quiet itself.

Why? Very simple. Its major competitor on the U.S. market, Tayloraid, does not have access to the Tokyo Stock Exchange direction and it buys the information from Quick.

That's the way you negotiate. You know Reuters has an advantage against its major competitor, Tayloraids, and therefore, is willing to forego its long-term competitive edge world-wide. World-wide.

Senator SHELBY. Mr. Chairman, thank you for your indulgence.

The CHAIRMAN. Thank you, Senator Shelby.

Mr. Silver, do we have any evidence of what would happen if the Europeans and the Japanese were to open their markets to the American securities industry? And how much do you think that would increase sales of domestic securities?

Mr. SILVER. Well, let me speak from the area in which I am familiar, and that's mutual funds. I didn't mention in my statement and perhaps I should have, that for the most part our foreign sales are effectively at ground zero. We're not permitted really to sell at all abroad.

Now, domestic sales are running about $125 billion a year. If we managed to sell 5 percent of what we're selling in the United States overseas, that would bring in $5 billion or $6 billion to the American capital markets through foreign sales, which is simply not available today.

And, of course, I might also mention that that kind of investment monies from small investors comes into the United States in the most benign form, in the sense that they're not take-overs of American industry in any way. They're true investment dollars.

The CHAIRMAN. Let me just stop you there. Would that, then, have the effect of enlarging the pool of equity capital, in a sense? Would that help lower the cost of capital in this country?

Mr. SILVER. It certainly would. And so many of these things interlock. This morning, I heard some comment on this panel that essentially, the interest deregulation really hasn't gone that far in Japan. The cost of capital to Japanese business is still very low.

Now, suppose American money market funds were permitted to sell in Japan. Would the Japanese consumer be content with 2 percent domestic interest when four times that amount would be available from American money market funds?

The entry of money market funds into Japan would have two effects, obviously. It would bring money into the United States, lowering the cost of money here. And perhaps it would raise interest rates in Japan, making money more scarce there.

So it's interesting the way these factors all interlock in a closed market. The exclusion of American mutual funds from the Japanese economy, as I say, has consequences in the cost of money in Japan and in the United States.

The CHAIRMAN. Gentlemen, you've given us outstanding testimony today. I'm very appreciative of the time and effort that it takes for all of you to be here, and to give us such an important part of the committee record and foundation that we need to move ahead.

I can assure you that we will make full use of this. Mr. Kim, I've got a question that I'm going to have you answer for the record, if I may. Mr. Hayden, I've got one that I'd like to ask you to answer. There are some other questions that members will be submitting to you to have you respond to for the record, and we would appreciate your doing so.

Let me again thank you very much. It's been a very constructive morning and the committee is very appreciative.

The committee stands in recess.

[Whereupon, at 12:25 p.m., the committee was recessed.]

[Response to written questions follow:]

DEPARTMENT OF THE TREASURY
WASHINGTON

UNDER SECRETARY

May 15, 1990

Dear Senator Riegle:

Enclosed please find my response to the questions submitted by you and Senators Dixon, Garn, and Sanford regarding the Fair Trade in Financial Services Act of 1990.

Please do not hesitate to contact me if I may be of further assistance.

Sincerely,

David C. Mulford
Under Secretary
International Affairs

The Honorable
Donald W. Riegle
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510-6075

Enclosures

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM

David C. Mulford

Q1.

Mr. R. Taggart Murphy, an expert on Japanese financial markets who in May will take on a new position with Goldman-Sachs in Tokyo, wrote an article entitled "Power Without Purpose" which appeared in the March-April 1989 edition of the Harvard Business Review. He stated in that article that:

> "Japanese commercial and investment bankers have succeeded overseas partly because of their diligence and attention to detail, but also because they can offer lower spreads and lower fees to borrowers thanks to the profits they enjoy from a cartel-like protected market at home."

Do you agree with Mr. Murphy on that point?

A1.

I have acknowledged repeatedly, including in my Financial Times article of November 29, 1989, that Japanese banks have benefitted significantly by interest rate restrictions in Japan. The substantial earnings Japanese banks have acquired in the regulated domestic market has enhanced their ability to pursue market share abroad aggressively. We have worked arduously in our Yen/Dollar talks (of the "U.S.-Japan Working Group on financial Markets") to remove interest rate restrictions in Japan, and while approximately half of all bank deposits have been deregulated and largely reflect market rates, 50 percent of Japanese deposits remain regulated. We are strongly urging the Japanese to adopt a more rapid interest rate deregulation timetable and will focus heavily on this issue at the May 1990 Yen/Dollar meeting.

Q2.

Mr. Eric Hayden, who also testified on April 5 and who spent several years working for the Bank of America in Japan stated on page 4 of his written testimony that in Japan:

> "Clearly written policies remain the exception rather than the norm, thereby ensuring the bureaucracy monumental power to interpret the law as it deems fit, which includes the ability to to intimidate financial firms."

Do you agree with that statement, and if so is that an issue being discussed in your talks with the Japanese?

A2.

Our desire to achieve greater transparency in the way that decisions are made and implemented in Japan has been an important element in our Yen/Dollar talks since their inception in 1984. We have raised this issue repeatedly and the Japanese have responded by undertaking efforts to include foreign firms in their consultation process as new issues come under review, and to make their policy decisions more clear. Nevertheless, we are aware that foreign firms are still frustrated by opaque informal practices. We are continuing to press for further improvements and plan to raise the issue again in our May Yen/Dollar meeting.

Q.3.

Senator Riegle: You told the House on February 28 that the United Kingdom Government has the power to retaliate against foreign countries that discriminate against its financial institutions. I understand that the United Kingdom has been a leader with the United States in encouraging other countries to liberalize and open their financial markets. Why does the Administration then think there is an inconsistency between having such power and still encouraging liberalization of the world's financial markets?

A.3.

Under Secretary Mulford: It is true that the United Kingdom has been a leader in seeking liberalization in financial markets around the world. Nevertheless, we opposed the reciprocity provision in the United Kingdom's Financial Services Act of 1986 when it was introduced because we feared that it would be copied by authorities in countries with a less liberal tradition than that of the United Kingdom.

As you may be aware, the reciprocity provision in the Financial Services Act of 1986 does not allow for any grandfathering, and is, therefore, potentially very restrictive. Our fears it might be copied by others were partially realized in the first draft of the European Community's Second Banking Directive.

Therefore, we continue to oppose reciprocity, even where its use would be left to the discretion of authorities with a tradition as liberal as Britain's, because of the risk that it might be used or that others with more restrictive tendencies could enact it and use it.

Q4.

You state on page 2 of your prepared testimony that the Yen/Dollar group, now the U.S.-Japan Working Group on Financial Markets, has met 13 times since early 1984. I understand that you have participated in most if not all of those 13 meetings and are quite familiar with Japan's financial market. If you had to submit the National Treatment Study required by the trade bill today, rather than in December, would you conclude that Japan provides U.S. financial firms national treatment?

A4.

I do not want to prejudge the conclusion of the National Treatment Study which Secretary Brady will submit to the Congress in December. Nevertheless, I have expressed my concern that barriers still exist which effectively prevent foreign firms from playing on a level playing field in Japan. De jure national treatment does not always result in de facto equality of competitive opportunity. Among other things, I have referred to Japanese laws and regulations as well as problems of transparency which continue to make full participation in the entire range of Japanese financial market activities difficult. Over the next few months as we prepare this report we will be discussing these issues with the Japanese and looking for further progress.

Financial Services in the Uruguay Round

Q.5.

Senator Riegle: You stated on page 4 of your prepared testimony that at Treasury's initiative finance officials have begun to craft an agreement in the GATT which would contain legally binding obligations calling for both market access and national treatment for financial institutions. My understanding is that under the draft Treasury proposals, the U.S. and other signatories would be able to retaliate against each other if they failed to carry out the commitment in the proposed agreement to grant national treatment. Why does the Administration accept such a principle in the GATT negotiations but not as a general proposition?

A.5.

Under Secretary Mulford: Our approach in the Uruguay Round is to seek multilateral obligations to govern the provision of financial services. We consider it entirely appropriate in that context for countries to agree on a mechanism to settle disputes and to enforce commitments under such an agreement. Action taken within such a framework of mutually agreed rules and obligations is different from unilateral action, which could encourage a damaging cycle of retaliation at the expense of the stability of the international financial system.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DIXON FROM

David C. Mulford

Q1.

First, I wish to congratulate you for your efforts in attempting to get the Japanese to open their markets to the GLOBEX product. I would appreciate your describing for the Committee the nature of Treasury's efforts in this regard and the response of the Japanese.

A1.

I raised this matter with the Japanese during the November 1989 Yen/Dollar meeting (of the "U.S.-Japan Working Group on Financial Markets") and emphasized the need to reach a speedy resolution of the problem. I expressed my disappointment with the delay the Chicago Mercantile Exchange had experienced not only in that meeting, but in my November 29, 1989 Financial Times article. In January I wrote to Vice Minister of Finance Utsumi, underscoring the importance I attached to this matter. My staff, including the Treasury attache in Tokyo, has pursued this matter continuously and I intend to raise it again at our Yen/Dollar meeting next month. The Japanese have acknowledged our concerns and appear to be moving towards a satisfactory solution, although the issue is not yet resolved.

Q2.

As you know from my opening statement, I intend to introduce parallel provisions to S. 2028 which deal with reciprocal national treatment for futures and options firms and exchanges. Would you care to comment on this proposal?

A2.

I consider futures and options exchanges an integral part of any efficient and sophisticated capital market. We would expect U.S. firms to receive national treatment in futures and options markets just as we expect U.S. firms to receive national treatment in any foreign bond, stock or money markets. I have concerns, however, about reciprocal national treatment (as opposed to national treatment) as it might be applied in any situation. I expressed the Administration's position in my April 5 testimony on S. 2028.

Q3.

What did you mean by the phrase "the situation invites Congressional action" in your November 29, 1989 Financial Times article?

A3.

This phrase was in regard to barriers which impede full access for foreign firms to Japanese financial markets. The phrase simply echoes the sentiment I have been hearing in regard to Congressional frustration with the slow pace of liberalization in Japan and the general lack of tolerance in the Congress for barriers to level playing fields abroad. It is my understanding that such frustration has fueled Congressional efforts to address access problems by legislative measures.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SANFORD FROM

David C. Mulford

Financial Services in the Uruguay Round

Q.1.

Senator Sanford: Mr. Mulford, in your testimony you touched briefly on the Uruguay Round of GATT talks. I would like you to comment on whether the Treasury Department is absolutely committed to the inclusion of financial services within the framework of those GATT talks.

If not, why not?

If so, why do you believe there have been rumblings among a number of U.S. financial services firms and others in Europe that the Treasury's position on the inclusion of financial services within the GATT talks less than clear?

Are there steps the Treasury Department should take to make its commitment more widely understood?

A.1.

Under Secretary Mulford: The Treasury is fully committed to seeking an agreement on financial services in the Uruguay Round. At Treasury's initiative, a group of finance officials has been meeting in Geneva since early last fall in an effort to reach a consensus on provisions that would govern financial services. In cooperation with the private sector, we have in fact developed and circulated a proposal on provisions that would apply to financial services in the Uruguay Round. Presumably those who may have questioned our position are unaware of these facts. I hope this reply makes clear the Treasury's commitment.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR GARN FROM

David C. Mulford

Q.1.

Senator Garn: Is the United States at a disadvantage in negotiations if it rules out any form of retaliation regardless of the practices of other governments?

A.1.

Under Secretary Mulford: The U.S. policy of national treatment was established not as a negotiating strategy, but to give U.S. consumers of banking services the benefits of an open, competitive market. We have been well served in our domestic market by our policy of national treatment. Abroad we have made some significant strides in opening foreign markets -- but often as a result of arduous negotiations. National treatment clearly has its limitations -- one being that it does not provide us a threat to use in our negotiations to open foreign markets. But we view reciprocity as a double-edged sword that, if used, risks retaliation, which could have a negative impact on confidence and established patterns of capital flows in world financial markets.

Financial Services in the Uruguay Round

Q.2.

Senator Garn: In the Uruguay Round negotiations on services, Treasury is seeking an agreement in which signatories would accept the obligation to offer right of establishment and national treatment to foreign financial institutions. Denial of national treatment would then open the way for retaliation. If such a regime is being sought in the GATT, why is domestic legislation to backstop this effort, akin to Section 301 of the trade law for goods, the threat to the free flow of capital that you testimony indicates?

A.2.

Under Secretary Mulford: In the Uruguay Round we are seeking to negotiate multilateral obligations to govern the provision of financial services. In that context, it is entirely appropriate to establish a mechanism, based on mutually agreed procedures, to enforce commitments under such an agreement. Action taken under the dispute settlement provision of a multilateral agreement is different from unilateral action, which could encourage a damaging cycle of retaliation at the expense of the stability of the international financial system.

Q.3.

Senator Garn: The EC Commission has pointed out various ways in which U.S. federal and state laws deny foreign banks national treatment. How likely is the EC to pursue removal of these barriers or threaten retaliation in those cases after 1992?

A.3.

Under Secretary Mulford: Article Nine of the EC Second Banking Directive provides for negotiations in two cases:

1. Where a third country does not grant EC credit institutions national treatment offering the same competitive opportunities as are available to domestic credit institutions and where conditions of effective market access are not fulfilled; and

2. Where a third country does not grant EC credit institutions effective market access comparable to that granted by the EC to credit institutions from that third country.

The Commission has the authority to impose sanctions in the case of a denial of national treatment (the first case). As the U.S. offers national treatment at the federal level, we do not anticipate that the EC Commission will impose sanctions against U.S. financial institutions. In speeches, EC Commission Vice President Leon Brittan has cited interstate banking compacts which discriminate against foreign banks and limitations on daylight overdrafts as instances where the U.S. does not offer national treatment. As long as the reciprocity concept remains in the Second Banking Directive, we cannot rule out sanctions on these grounds; however, the EC Commission has indicated to us that it does not intend to impose sanctions on the U.S. for these exceptions to our national treatment policy.

In pursuit of "effective market access comparable to that granted by the EC", the Commission has expressed its interest in discussing Glass-Steagall and McFadden Act restrictions on U.S. bank activities and regional expansion. There are no punitive measures attached to negotiations for access comparable to that offered by the EC. This is in recognition of the legitimacy of differing regulatory systems that offer national treatment though not mirror-image treatment. We anticipate the EC will pursue removal of these barriers, but the EC's agenda for discussion will depend upon its own timetable and the progress between now and 1993 of various proposals for regulatory reform in the U.S.

Financial Services in the Uruguay Round

Q.4.

Senator Garn: Private sector groups and EC officials have expressed concerns to members of the Banking Committee that Treasury is not committed to including a financial services agreement in the GATT, that Treasury would rather "carve out" financial services and handle negotiations on a country by country basis. We understand that the USTR wants to keep financial services as part of the overall GATT services negotiations. What is Treasury's view? Are you committed to keeping financial services in the GATT? If not committed, what are your specific concerns?

A.4.

Under Secretary Mulford: The United States is committed to seeking an agreement on financial services in the Uruguay Round negotiations. Neither this Administration, nor other countries have decided what sectors will be covered by a general framework agreement on services. The relationship of a Uruguay Round agreement covering financial services, or for that matter other services, to the institutional arrangements of the GATT has not yet been determined. One of the various considerations involved is our ability to negotiate an agreement that accomplishes meaningful liberalization in the financial area, while safeguarding prudential regulation of the financial system. We view these multilateral negotiations as a useful complement to our bilateral efforts to liberalize barriers in the financial area. These efforts are of equal importance and are proceeding on parallel tracks.

Responses to
Questions for Mr. David Silver
From Senator Donald W. Riegle, Jr.
April 5, 1990

Q.1 Mr. Hayden stated on page 4 of his prepared testimony that he has spoken with representatives of major banks and investment firms about their reluctance to testify in favor of S. 2028. He concludes their reluctance is based on the fact that many have a profitable, though small niche in the Japanese market, and therefore are insiders and don't want to make waves. Such caution, he surmises, may be reinforced by their fear of the inordinate power of Japanese financial authorities.

Do you think Mr. Hayden's observation is a valid one?

A.1. We have no direct evidence of the reasons for the reluctance of major banks and investment firms to testify in favor of S. 2028 However, in view of the nature of the pervasive but informal regulatory atmosphere in Japan, we can understand that there would be a reluctance on the part of those entities to speak out or "make waves." As I indicated in my testimony, the regulatory environment in Japan is extremely subjective and noticeably lacking in bright-line standards or clear rules of conduct. Such an environment could well have a chilling effect on those American firms that have merged to gain entry to the Japanese markets. I might also note that it is not unheard of even in the United States for those in a highly regulated industry to attempt to avoid confrontations with their regulators.

Q.2. In your discussions with the Japanese, were you able to learn what their reason might be for not opening their market to new entrants?

A.2. When we inquired of the Japanese Securities Bureau regarding their reason for not opening the Japanese market to new entrants, we were informed that it is because the Japanese Securities Bureau (the analogue of our Securities and Exchange Commission) is small and inadequately funded, without the level of resources of the U.S. SEC. As a result, they explained, the Securities Bureau is not in a position to exercise extensive ongoing supervision of participants in the Japanese markets. Accordingly, they believe it important to screen potential entrants thoroughly and to limit the number of such entrants at the outset.

disclosure was unnecessary and decided to drop the bill.

New York Proposes New Tax on Services. The New York State legislature is considering raising revenues for its budget by taxing certain services. Although ICI has been informed that the proposed tax is not intended to apply to mutual fund advisory fees, the bill's language is unclear. The Institute is seeking clarification that this tax is not applicable to advisory fees.

SEC Chairman to Speak at General Membership Meeting. SEC Chairman Richard Breeden will address more than 1,100 industry representatives attending the Institute's General Membership Meeting being held in Washington on May 9-11. Focusing on "Strategies for the 90s," major segments of the program will deal with international investment company developments, marketing, and business planning issues. A record attendance is expected.

New Funds in Registration. In the past two weeks, ten new open-end and three new closed-end funds were registered with the SEC. The open-end funds include a high-yield bond fund that characterizes its investments as "junk bonds" in accordance with new SEC disclosure guidelines, three global funds, and two series funds. The closed-end funds consist of two municipal bond funds that intend to issue preferred stock shortly after the common stock offering, and a European fund. For more detailed information about these and other new products, please consult the FUNDS file, "New Funds in Registration." Because this file is updated every Monday, new funds reported in QuickFacts that were received in the last part of each two week reporting period may still be in the Institute's review process and will be available on the following Monday.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM

Eric Hayden

Q.1. On April 1 the Washington Post carried an article about our ongoing trade talks with the Japanese. It quoted Commerce Undersecretary J. Michael Ferran, who has a big role in those talks, as stating:

> **"Japanese corporations use a protected domestic market, with Japanese consumers paying higher prices, in order to price aggressively in foreign markets, thereby gaining market share and often mortally wounding foreign competitors."**

Do you think that is true, and if so do you think the same thing is happening with regard to financial services?

A.1. Higher domestic prices in Japan certainly help manufacturers keep their prices lower in foreign markets. It's not certain that a similar situation exists in the financial services industry, where price competition is quite keen.

Answers to Questions for Mr. Charles Kim
From Senator Donald W. Riegle, Jr.
April 5, 1990

Q.1. Mr. Silver, who also testified on April 5, stated the following on page 4 of his prepared testimony:

> "there seems little doubt that foreign firms which develop and grow in the sheltered environment of a restricted market may benefit from the existence of a monopoly or oligopoly in their home market. The profits gleaned from growth in this protected environment may provide a significant boost to entry into another market, such as the U.S.?
>
> Do you agree with Mr. Silver's remarks?

A.1. I generally agree with Mr. Silver's remarks. In the case of Korea, the situation is slightly different. Korean banks are are not as concerned with maximizing profits as banks in other countries. They do have a well-protected market in the home country, however, which no doubt reinforces their ability to compete on U.S. soil. My experience leads me to believe that this is even more so with other countries. As I stated on page 2 of my written testimony: "Some of these countries operate in a protected home market, subsidizing their activities and ability to conduct predator acquisitions."

Q.2. Some critics of S. 2028 have stated informally that the Independent Bankers Association should not have been invited to testify at the April 5 hearing because they are not affected by the bill and therefore have "no dog in this fight."

Can you explain to us very briefly why this bill is important to the community bankers of this country?

A.2. The Independent Bankers Association of America testified in support of S. 2028 for a variety of reasons. Our testimony clearly indicated that this is an issue which has importance to our members:

a. Community bankers have taken a national view of this, and other, issues and have identified national treatment as an issue with important consequences for our economy. The IBAA membership adopted a resolution at its annual convention in March 1990 "stating, in part, that 'IBAA is deeply concerned about the growing number of U.S. banks controlled by foreign interests and the increasing control of U. S. financial resources by foreign interests...we believe that the home country of the foreign acquiror should provide national treatment to U.S. banks seeking to establish or currently operating banking institutions in that country.'" (pages 1-2 of testimony)

b. Community bankers have recognized that the growth of foreign ownership of U. S. financial institutions "is not only in major market market areas, but also in small pockets across the nation where community banks prosper." (page 2 of testimony)

c. Many of our members, particularly in the immigrant community, "may be interested in seeking entry as a U. S. bank into their home country's financial market by opening a branch. We would obviously wish to be accorded effective access to the foreign country's market." (page 2 of testimony)

d. Finally, S. 2028 is about fairness, and fairness is an issue in which all Americans have an interest.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM

Gunter Pauli

Q.1. On April 1 the Washington Post carried an article about our ongoing trade talks with the Japanese. It quoted Commerce Undersecretary J. Michael Ferran, who has a big role in those talks, as stating:

> "Japanese corporations use a protected domestic market, with Japanese consumers paying higher prices, in order to price aggressively in foreign markets, thereby gaining market share and often mortally wounding foreign competitors."

Do you think that is true, and if so do you think the same thing is happening with regard to financial services.

EUROPEAN SERVICE INDUSTRIES FORUM

V.Z.W.-A.S.B.L.

the network of performing service companies

the Hon. Donald Riegle
Chairman
US Senate Banking Committee
Washington DC, 20510-6075
USA

Berlaar, 03.05.1990

to the attention of Ms Lorry Breneman

Dear Mr. Riegle,

Thank you for your letter and the additional questions you have put forward to me. I will try to respond briefly to the two points raised.

1. The Japanese do have the opportunity to increase prices on the home market and in this way subsidize exports. This is also happening in financial services. The interest rate offered to Japanese savers on the Japanese market are well below internationally accepted minima. Japanese Pension funds in particular have the lowest return from any modern economy.

Second, the Japanese have the habbit of cross-subsidizing interests. When a company is considered highly strategic it will benefit from below prime interest rates in a collective effort to facilitate its expansion. other - less strategic or financially more sound companies of the same group- will pay a higher interest rate to compensate for the loss of income with the bank.

The low cost of capital has often been cited as the prime reason why the Japanese are so good in offering cut throat government lending.

Though the market to watch is credit cards. This is a market segment traditionally dominated by Western financial institutions. JCB spearheads an international expansion which is driven in the first place by its ability to offer financing to foreign clients through its cheap access to funds which is not available to AMEX, Visa or Diners. The Japanese themselves quote this as a competitive edge (see text of my intervention at the hearing).

Q.2. There is sometimes confusion in this country between what Article 9 paragraph (4) of the Second Banking Directive empowers the Commission to do, and what Article 9 paragraph (3) empowers it to do. Can you explain the difference between those two articles and explain which would be relative to our Glass-Steagall law?

2. The second banking directive article 9 §4 stipulates that the Commission of the EC can propose to the Council of Ministers to investigate and eventually to propose retaliation in case countries do not offer equal access to their markets as the Commission is offering to these foreign institutions.

The same article §3 clarifies that the Commission of the EC can investigate if the EC banks and the banks of the country concerned cannot offer financial services as is permitted in the EC, though this applies to both EC banks and the banks from the company concerned.

Concretely it means that the Commission of the EC takes note of the fact that the Glass-Steagall Act restricts banking services in the US, but that this applies to both American and European (or any other bank). Even though the Commission offers a much broader action, no retaliatory measures can be proposed.

The major difference lies in the possibility to retaliate.

I hope that these two questions have been sufficiently answered. In the mean time, I remain,

With great respect,

D. JANSSENS
private secretary
of Mr. Gunter PAULI

NEW ADDRESS
as of May 1, 1990
't Hooghuys
B-2580 Berlaar - Belgium
Tel. +32 3 482 47 91
Telefax +32 3 482 47 96

Zeeptstraat 55, B-2850 Keerbergen - Belgium - Tel. (32 15) 51 70 80 - Fax (32 15) 51 49 02 - Tlx 65525
GBM-SGB 220-0228285-80 - B.T.W. 428.255.889